

Single Audit/Grant Training

FY 2003-2004

Presented By:

**Office of Superintendent of Public Instruction
and
Washington State Auditor's Office**

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Federal Laws and Regulations

Listed below are the primary OMB Circulars that apply to schools receiving federal assistance.

ADMINISTRATION OF GRANTS

- ❖ The Common Rule, *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*

GRANTEE COST PRINCIPLES

- ❖ OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*

AUDIT REGULATIONS

- ❖ Single Audit Act of 1984
- ❖ Single Audit Act Amendments of 1996
- ❖ OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*
- ❖ OMB Circular A-133, *Compliance Supplement*

The Common Rule Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments

- ❖ Establishes uniform administrative rules for federal grants and cooperative agreements and sub-awards to state, local and Indian Tribal Governments.
- ❖ Provides requirements for the following:
 1. Financial management systems
 2. Payment
 3. Allowable costs
 4. Period of availability of funds
 5. Matching or cost sharing
 6. Program income
 7. Non-federal audits
 8. Changes in program and budget
 9. Real property
 10. Equipment
 11. Supplies
 12. Copyrights
 13. Subawards to debarred or suspended parties
 14. Procurement
 15. Sub-grants
 16. Monitoring and reporting program performance
 17. Financial reporting
 18. Records retention and access
 19. Enforcement
 20. Termination and close-out of grant
 21. Disallowances
 22. Collection of amounts due

OMB Circular A-87
Cost Principles for State, Local and Indian Tribal Governments

- ❖ Establishes principles and standards for expending funds for federal awards carried out through grants, cost reimbursement contracts, and other agreements.
- ❖ Sets forth the general principles for determining allowable costs.
- ❖ Provides guidelines for many types of direct expenditures, indirect costs, and cost allocation plans.
- ❖ Outlines time and effort requirements.

OMB Circular A-133

Audits of States, Local Governments, and Non-Profit Organizations

- ❖ Establishes uniform audit requirements for states, local governments, colleges, universities, hospitals, and other non-profit organizations.
- ❖ Any grantee that expends over \$300,000 in federal awards in a year must have a single audit conducted in accordance with Circular A-133.
- ❖ Distinguishes between subrecipients and vendors.
- ❖ Discusses frequency of audits, sanctions, and audit costs.
- ❖ Outlines **Grantee's** responsibilities for:
 1. Preparing financial statements.
 2. Preparing schedule of expenditures of federal awards.
 3. Establishing internal controls over federal programs.
 4. Complying with laws and regulations.
 5. Monitoring subrecipients.
- ❖ Provides responsibilities for cognizant and oversight agencies.
- ❖ Lists items to be included in audit reports, and items to be reported as findings.
- ❖ Introduces risk-based approach in determining major federal programs.
- ❖ Provides criteria on how to qualify as a "low-risk auditee."

Circular A-133 Compliance Supplement

- ❖ Official supplement to OMB Circular A-133
- ❖ Sets forth 14 primary compliance areas that should be considered in an audit conducted under A-133.
 - 1. Activities Allowed and Unallowed
 - 2. Allowable Costs / Cost Principles
 - 3. Cash Management
 - 4. Davis-Bacon Act
 - 5. Eligibility
 - 6. Equipment and real property management
 - 7. Matching, Level of Effort, or Earmarking
 - 8. Period of Availability
 - 9. Procurement; Suspension and Debarment
 - 10. Program Income
 - 11. Relocation Assistance and Real Property Acquisition
 - 12. Federal Financial Reporting
 - 13. Sub-recipient Monitoring
 - 14. Special Tests and Provisions
- ❖ Provides specific compliance criteria for approximately 100 federal programs.
- ❖ Provides guidance for implementing internal controls over federal programs.

INTERNET RESOURCES

Federal Office of Management and
Budget (OMB) Circulars
(Click on Grants Management)

<http://www.whitehouse.gov/OMB>

Catalog of Federal Domestic Assistance
(For Obtaining CFDA numbers)

<http://www.cfda.gov/>

Federal Clearinghouse-Data Collection
Form (Prepare This Form Online)

<http://harvester.census.gov/sac/>

List of Debarred and Suspended Parties
(Cannot Do Business With Federal
Funds)

<http://www.arnet.gov/epls>

US Government Printing Office
(Includes Quicklinks to Code of Federal
Regulations, or CFR's and U.S. Code)

<http://www.gpo.gov/>

US Department of Labor (Information on
Prevailing Wages)

<http://www.dol.gov/>

Code of Federal Regulations (CFRs)

<http://www.access.gpo.gov/nara/cfr>

Washington State Auditor's Office

<http://www.sao.wa.gov/>

Office of Superintendent of Public
Instruction

<http://www.k-12.wa.us>

Codification of Common Rule by all
Federal Agencies

<http://www.whitehouse.gov/OMB/grants/chart.html>

FEDERAL AGENCY WEB SITES

Agriculture	http://www.usda.gov/
Commerce	http://www.doc.gov/
Education	http://www.ed.gov/
Energy	http://www.energy.gov/
EPA	http://www.epa.gov/
FEMA	http://www.fema.gov/
Health and Human Services (HHS)	http://www.os.dhhs.gov/
HUD	http://www.hud.gov/
Interior	http://www.doi.gov/
Justice	http://www.usdoj.gov/
Labor	http://www.dol.gov/
Transportation	http://www.dot.gov/
Veterans' Affairs	http://www.va.gov/
Corp for National and Community Service	http://www.cns.gov/

ADDITIONAL RESOURCES AND ASSISTANCE

U.S. Census Bureau Federal Audit Clearinghouse (FAC)
For questions about the Data Collection Form
1-888-222-9907

Federal Publications
U.S. Government Printing Office
Seattle (206) 553-4270

Office of Management and Budget (OMB)
Financial Management Division
Washington, DC
(202) 395-3993

Single Audit Information Service
Thompson Publishing Group
1-800-677-3789
<http://www.thompson.com/>

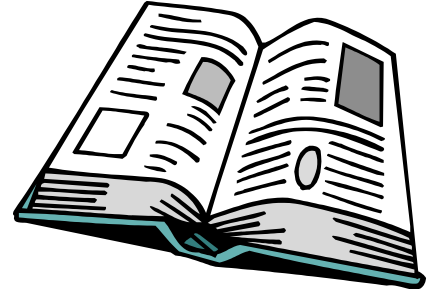
Federal Grants Management Handbook
Thompson Publishing Group
1-800-424-2959
<http://www.thompson.com/>

WA State Auditor's Office
School Specialist
(360) 664-3147
bergej@sao.wa.gov

OSPI
Federal Program Specialist
(360) 725-6229
bpaulson@ospi.wednet.edu

Grant Accounting

- The Washington State Accounting Manual for Public School Districts outlines the accounting guidelines for grants for all school districts.
- Expenditure and revenue codes for grants received through OSPI are included in Web Apps.
- For grants received either directly or from another pass through, consult the Accounting Manual for proper coding.
- Sub-accounts should be used for all grants (i.e., District may have three grants coded to revenue code 6100) to enable grant activity to be identified and properly accounted for.
- Grant files with all pertinent grant information should be maintained.
- Sub-codes should be used for all earmarks or set-asides.
- Document permission by the grantor to use grant funds for those items that are either not clearly allowed for under the grant award, or were not included in your original grant application or budget.



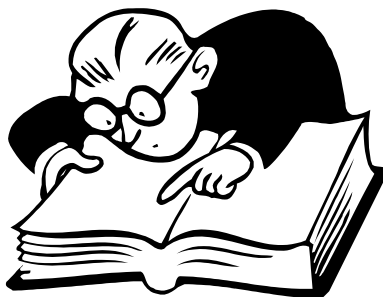
Transferability

- Districts must notify OSPI 30-days prior to using this option.
- Funds may be transferred from one NCLB formula program to another, and into, not out of Title I.
- All transferred funds must be spent according to the requirements of the fund to which they were transferred.
- Transferred funds are subject to all set-asides.

Example: Funds are transferred into Title I, the district must calculate the mandatory Title I set-asides (e.g., 1 percent for parent involvement, 20 percent for AYP requirements, if applicable) using a base amount that includes the transferred funds. Funds transferred into Title I would also effect all of the allocations made to school buildings.



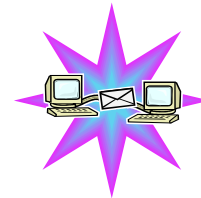
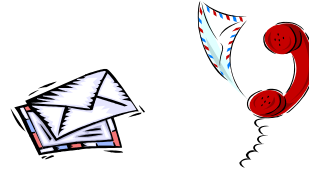
- Districts must still claim grant expenditures in the program where they were originally awarded. Careful tracking and sub-coding must occur to maintain adequate accounting records.



SEFA Bulletin

Changes to SEFA

1. Must be submitted to SAO by November 17, 2003.
2. The notes to the SEFA have been expanded to include disclosures for those districts operating schoolwide programs, and/or exercising the transferability option provided for by No Child Left Behind (NCLB) or the Small Rural Schools (SRSA) option.



Common Errors

1. Expenditures on SEFA don't match expenditures in accounting records.
2. Notes to the SEFA are missing.
3. Direct and indirect awards are misclassified.



Time and Effort



Q: What is “Time and Effort” Reporting?

A: Federal regulation requires that any salaries and benefits charged to a federal award(s) must be supported by documentation that meets the following criteria in order to be allowable charges to the award(s):

- The employee's time must be documented in writing.
- The documentation should reflect the **actual** time spent by the employee on activities of the federal program(s) being charged.
- The period covered by the documentation may not exceed one month unless an approved substitute system is in place or the employee works on a single cost objective.
- The documentation should account for **all** of the employee's time for the period covered (including state/local activities).
- The documentation should be signed by the employee.



This requirement applies to all Federal awards and subawards, including those received directly from the federal government, unless specifically exempted by the Office of Management and Budget (OMB).

Q: How do I know whether or not I should prepare time and effort reports?

A: Time and effort reports should be prepared by any certificated and classified staff with salary and benefits that are charged:

- Directly to a federal award.
- Directly to multiple federal awards.
- Directly to any combination of a federal award and other federal, state or local fund sources.
- Directly to any non-federal funds to meet federal cost sharing or matching requirements.

Q: What determines whether an employee reports monthly or semi-annually?

A: If the employee's salary and benefits are charged directly to a single federal award or to a single cost objective, time and effort may be reported **semi-annually, referred to in the federal regulations as "Semi-Annual Certification."** However, district policy may require employees to report monthly.

Q: What is a "single cost objective"?

A: A single cost objective is a single set of work activities that are allowable charges under one or more fund sources. Most commonly, single cost objectives include:

- A single federal grant award activities
- A combination of federal Title I and state Learning Assistance Program (LAP) funded activities
- A combination of federal Special Education and state Special Education Program funded activities

Q: Is T&E documentation required for staff working in a school building that has a schoolwide program in place?

A: Yes, time and effort documentation is required for staff that are charged **solely to federal/state/local funds that have been combined** in a schoolwide program.

Yes, for any building employee(s) charged, in whole or in part, to federal/state/local programs that have **not been combined** in the schoolwide program.

➤ For any employee charged to multiple federal funds and state/local funds, all funds that have been combined in the schoolwide program may be documented as a single-cost objective, "Schoolwide Program," with non-combined funds being recorded as separate cost objective(s).

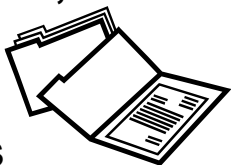
➤ Federal Department of Education funds that may be combined in a Schoolwide Program are listed in OSPI Bulletin No. 62-02. State and local funds that may be combined are limited to the following:

–Basic Ed Apportionment
–Learning Assistance Program

–Levy Equalization
–Local Levy Revenue

➤ US Dept of Education Schoolwide Program Guidance directs that "an LEA must be able to show the amount of funds from each federal education program for each grant year that the LEA allocated to a schoolwide program." This guidance can be found at: http://www.ed.gov/legislation/ESEA/Title_I/swpguid1.html



Q: Is time and effort required for stipends, supplemental contracts, and/or extra hours?**A: Yes**

➤ Sign-in/attendance logs may be used as time and effort documentation for extra hour pay related to a single cost objective (e.g., pay for professional development activities under Title II, Pt. A – Highly Qualified Teachers)

➤ A signed supplemental contract that stipulates a specific single cost objective duty/assignment may be used as time and effort documentation (e.g., pay for supplemental, after school reading instruction charged to Title I, Part A) so long as staff provides a certification of contract completion.

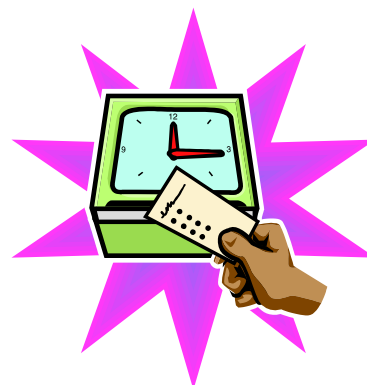
➤ A stipend for performing a specific single cost objective responsibility may be used as time and effort documentation so long as the employee signs the stipend and an after-the-fact certification of performance (e.g., pay for supervision of a particular federal program charged).

➤ Multiple cost objective supplemental contracts/stipends must be supported by time and effort reports documenting actual time spent on each objective (e.g., pay for a supplemental contract to administer a summer school program serving Title I and Special Ed eligible students may be charged to Title I and Special Ed only if supported by a time and effort report).

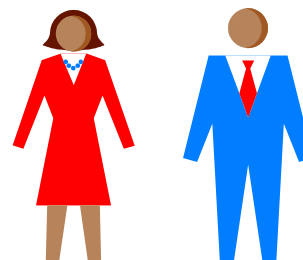


Q: Can administrators charge time to federal programs?**A:** Yes and No.

- Federal program directors can do so as long as they maintain monthly time and effort documentation supporting actual time charged to each federal and state program under their supervision.
- Chief Executive Officials are considered a general government cost, and generally may not charge time to federal awards (pursuant to the supplement, not supplant provision). The only exception to this rule is when any such official has specific program administration or direct student service duties and documents actual time spent in the performance of those duties by completing monthly time and effort records.

**Q: Who are chief executive officials?****A:** Chief executive officials are:

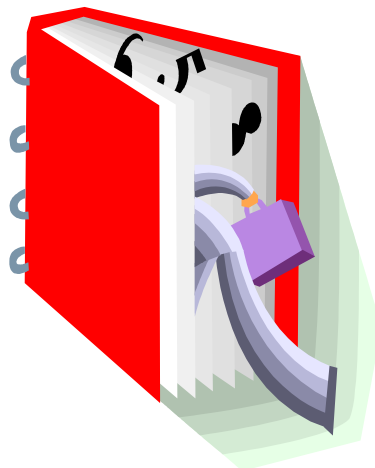
- Superintendents
- Assistant Superintendents
- Building Principals
- Assistant Building Principals
- Support staff for those listed above



Q: What is a “substitute system”?

A: Federal guidance allows grantees and subgrantees subject to time and effort requirements the option of developing substitute time and effort systems.

A substitute time and effort system is simply a methodology whereby time and effort for multiple cost objective staff is allocated to each objective based on a sample rather than being a record of actual time spent on each objective for each day of the month.



Examples of some statistically sound sampling systems are:

- Allocation of time proportionate to student counts that vary from day to day (blended class periods)
- Allocation of time proportionate to staff schedule that varies (no blended class periods)
- Allocation of time proportionate to eligible student counts during each daily class period aggregated over a five day sampling each month (frequent changes in class period enrollments of eligible students and/or frequent schedule changes).

Substitute systems must be approved by the grantor agency before they can be used.

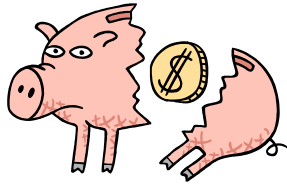
Q: Has the reauthorization of the Elementary and Secondary Education Act affected time and effort requirements?

A: No—time and effort reporting is a government-wide requirement by OMB. The implementation of No Child Left Behind does not affect OMB Circular A-87 cost principles.

Q: Are there common errors in time and effort reporting that I can avoid?**A:** Yes. Some examples are:

- Failing to recognize that a change in position, duties, or funding may result in a change in time and effort reporting. Often this is due to a lack of coordination/communication between fiscal, human resources, district program directors, and school building offices within the district.
- Failing to provide training to staff who are responsible for completing, approving, and/or reconciling time and effort documentation.
- Reporting time according to the ratios budgeted without regard to how the individual actually worked.
- Failing to adjust actual payroll charges based on reported time and effort when the difference is less than 10%. This 10% standard applies to adjustments of budgeted payroll on a quarterly basis but does not waive the requirement for an annual expenditure adjustment to align payroll with time and effort.
- No independent review by someone other than the employee/supervisor to ensure that necessary payroll adjustments are performed to reflect actual time worked.
- Time and effort not reviewed and signed by appropriate staff.
- Entire days schedule not accounted for (only federal program time reported).
- JV's transferring payroll expenditures to federal programs (from state/local sources) or between federal awards, with no supporting time and effort documentation.
- Lack of appropriate time and effort records for employee(s) with supplemental contracts/stipends and extra hours.
- Lack of appropriate time and effort records for employee(s) charged to federal awards received from an agency other than OSPI.





These problems can be costly to your district!!! They may result in:

- Inappropriate charges to federal programs.
- Inaccurate management information for decision-making.
- Increased risk of audit findings / questioned costs by state auditor.
- Program and fiscal compliance issues under sub recipient monitoring.

Q: Where can I find the applicable regulations / rules / other guidance?

A: OMB Circular A-87, Attachment B, Section 11h.
(Refer to Appendix)
OSPI's Time and Effort Bulletin 49-02



Prior Year's Audit Issues

Summary

Number of Findings	Number of Districts	Total Questioned Costs
68	54	\$1,640,769

Number of Findings	Federal Grant
25	Title I
23	Special Education
7	Medicaid
13	Other

Audit Issue	Number of Districts	Total Questioned Costs
Activities Allowed/unallowable costs	2	\$85,192
Comparability	3	
Davis-Bacon	1	
Eligibility – Title I	3	
Impact Aid	1	
Medicaid	7	\$455,356
Private School Participation	2	
Reimbursement requests	1	
School Lunch - Verification	2	
Schoolwides	3	
Subrecipient Monitoring	1	
Time and Effort	42	\$1,100,221
Total	68	\$1,640,769

Time and Effort – various grants

- Lack of appropriate documentation

Activities Allowed/unallowable Costs

- Charges were not allowed per the grant agreement



Comparability

- Comparability worksheets had not been completed

Davis-Bacon

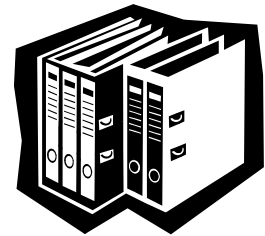
- One school district received a special grant for construction but did not get certified payrolls as required

Eligibility – Title I

- Adequate supporting documentation to support eligibility in targeted assistance programs was not maintained

Impact Aid

- Impact aid special education expenditures were not identified



Medicaid

- Lack of internal controls over program
- Reimbursements were not supported by reasonable time studies

Private School Participation – Class Size Reduction

- Private schools were not invited to participate when money was spent on professional development



Reporting

- Reimbursement requests for federal grants were not supported, and amounts were overclaimed

Verification – School Lunch

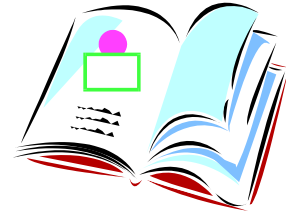
- Verification process required by grant was not performed and/or ineligible students were not removed from free and reduced lists



Schoolwide Plans



- One district did not meet the poverty level required to have schoolwides
- One district's plans did not contain all required components
- Districts did not include funding sources in plans



Subrecipient Monitoring

- One district did not appropriately monitor their Subrecipient

Other Issues

- Special education counts and IEPs



Supplement, Not Supplant and Maintenance of Effort Provisions

Supplement, Not Supplant

- Based on theoretical question, “What funding would have been used in the absence of the federal funds?”
- If applicable, federal grant funds must be used to supplement (increase), and not supplant (replace) other funding.
- Provisions are applicable to a particular program or portion of program and so differ from program to program. Some prohibit supplanting only state and local funds, others prohibit supplanting other federal funds as well. Some have special provisions that allow exceptions under specific circumstances.



- The OMB Circular A-133 Compliance Supplement and some program-specific USDE nonregulatory guidance list examples of circumstances under which supplanting is presumed and under which a presumption of supplanting can be rebutted.
- If applicable, indirect costs must be recovered using a restricted indirect cost rate.
- A matrix that summarizes the supplement, not supplant provisions for NCLB is included in the materials in the appendix.

Maintenance of Effort

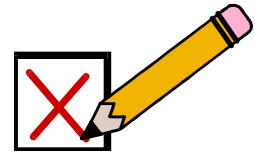


- Based on mathematical calculation.
- If applicable, requires that a minimum amount of state and local funds (usually based on a base year) continue to be spent for particular activities each fiscal year. Failure to maintain the maintenance amount may result in loss or reduction of federal funds. Waivers may be approved by the awarding or pass-thru agency under certain circumstances.
- Provisions are set in statute and differ from law to law and sometimes between programs or portions of programs within a law.

A more detailed discussion of supplement, not supplant, maintenance of effort, and comparability provisions under NCLB is included in the materials in the appendix.

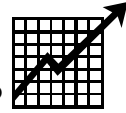


Special Education – Pass or Fail



- Required to pass ONE of four of the maintenance of effort tests on F-196
 - Total aggregate
 - Total aggregate per pupil
 - Local aggregate
 - Local aggregate per pupil
- Careful budgeting and monitoring is needed!
- 20% Rule
 - Applies in any year in which Part B funding exceeds \$4 billion (FY03 Part B = \$9.7 billion)
 - Districts may treat 20% of the increase in allocation from previous year to current year as LOCAL funds
 - Districts should consider this during their budgeting process



- If your 1077 Excess Cost back-out percentage goes UP , you need to quantify the dollars associated with this, as a failure due to excess cost accounting is considered an allowable exception
- Exceptions for:
 - change in personnel
 - decrease in enrollment
 - transfer of high cost child
 - termination of capital expenditures
- Example calculation



No Child Left Behind

Challenges to School Districts



District / School Set asides

Title I, Part A

- Required
 - To serve homeless children who do not attend participating Title I schools (sec. 1113 (c)(3)(A)).
 - 1% for parent involvement (if LEA allocation is over \$500,000)-under NCLB 95% of reserved funds must now be distributed to schools (sec. 1118(a)(3)).
 - Not less than 5% or more than 10% of the district Title I allocation in SY2003 and SY2004, and not less than 5% of the funds for subsequent years for professional development to help teachers become highly qualified (sec. 1119(l)).
 - To provide equitable services to eligible private school students who reside in the district and ensure that teachers and families of the children participate on an equitable basis, in services and activities developed in accordance with Title I professional development and parent involvement provisions (sec. 1120(a)(1)).

- Required for Schools Identified for School Improvement
 - Amount equal to 20% of district's Title I, Part A allocation (unless all requests can be satisfied with a lesser amount) must be set aside for transportation for public school choice and supplemental educational services (sec 1116(c)(10)) and USDE Draft Non-regulatory Guidance
 - Minimum of 5% for transportation for choice (if needed)—non supplant provisions apply.
 - Minimum of 5% for supplemental educational services (if needed).
 - Remaining 10% for either or both.
 - Funding does not have to come from Title I, Part A, may be state or local moneys
 - 20% cannot include administration related costs
 - If funds are insufficient to meet the need for transportation, priority goes to lowest achieving students from low-income families, but all students in identified schools must be offered choice
 - Obligation to pay transportation continues as long as the school is in school improvement, choice option continues at parent option until the student has completed highest grade available at school of choice.
 - District cannot reduce allocations to schools identified for improvement by more than 15% as a result of these set asides (sec. 1116(b)(10)(D)).
 - At least 10% of the *school's* Title I, Part A allocation for teacher and principal professional development activities during each fiscal year the school is identified for improvement (sec. 1116(b)(3)(A)(iii)). (Note-If the *district* is identified for improvement it must spend 10% of the district Title I allocation for professional development *in addition* to the set aside required in sec. 1119 to help teachers become highly qualified. However, the 10% school level professional development set asides for schools identified for school improvement may be counted toward the district 10% minimum (sec 1116(b)(7)(A)(iii)).

- Optional
 - No more than 5% to provide incentives and rewards to teachers to work in Title I schools that are in improvement, corrective action or restructuring for the purpose of attracting and retaining qualified and effective teachers. May also use Title II, Part A funds for this purpose. (Section 1113(c)(4))
 - To cover necessary and reasonable administrative costs of the Title I program

Title II, Part A

- Required
 - To provide equitable services for private school children, teachers, and other educational personnel serving those children comparable to services and other benefits for public school children, teachers, and other educational personnel participating in the program (sec. 9501(a)(3)).
 - Equal on a per pupil basis (sec. 9501(a)(4)).
 - For purposes of determining the amount of Title II, part A funds that the district must make available for equitable services to private school teachers, NCLB requires the district to assume that it is spending at least as much for professional development under Title II, part A as it did in SY2002 under the Eisenhower program (sec. 9501(b)(3)(B)).

Title II, Part D Enhancing Education Through Technology

- Required
 - To provide to private school children and their teachers or other educational personnel, on an equitable basis, special educational services or other benefits that address their needs under the program (sec. 9501(a)(1)).
 - At least 25% of award (both formula and competitive) for professional development in the integration of advanced technologies, including emerging technologies, into curricula and instruction and in using technologies to create new learning environments (sec.2416 (1)).

Title IV, Part A Safe and Drug Free Schools and Communities

- Required
 - To provide to private school children and their teachers or other educational personnel, on an equitable basis, special educational services or other benefits that address their needs under the program (sec. 9501(a)(1)).
- Optional
 - May spend up to 40% of the award on certain school security activities (listed in the law) at least half of which must be used for hiring and training school security personnel who interact with students in support of violence and drug prevention activities (sec. 4115(1)).

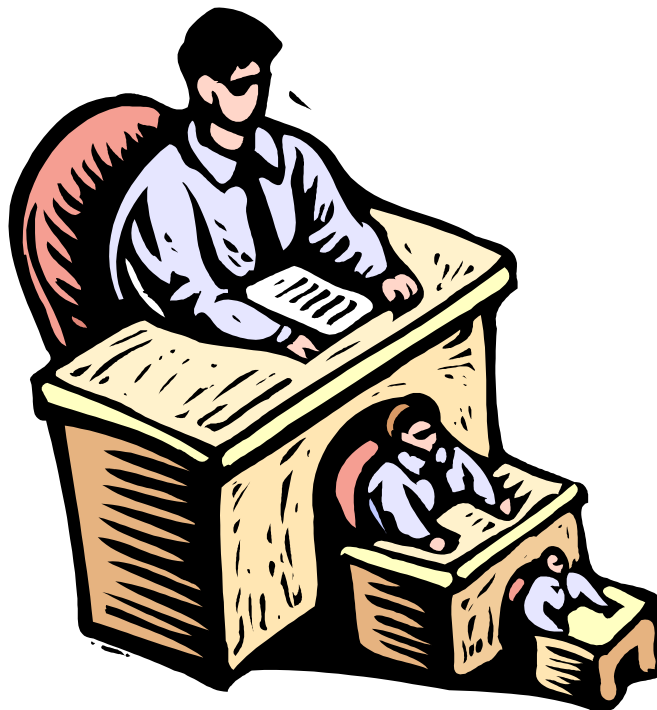
Title V, Part A Innovative Programs

- Required
 - To provide to private school children and their teachers or other educational personnel, on an equitable basis, special educational services or other benefits that address their needs under the program (sec. 9501(a)(1)).

New Caps on

LEA Charges for Administrative Activities for Certain Programs

- T.1, Part B, Subpart 1 – Reading First
 - Not more than 3.5% (section 1202(c)(8))
- T.III, Part A, Subpart 1 – English Language Acquisition and Language Enhancement
 - Not more than 2% (section 3115(b))
- T.IV, Part A, Subpart 1 – Safe and Drug Free Schools and Communities
 - Not more than 2% (section 4114(a)(2))
- Fiscal Impact : Plan for limitations in funding for administrative activities for affected programs, monitor compliance.



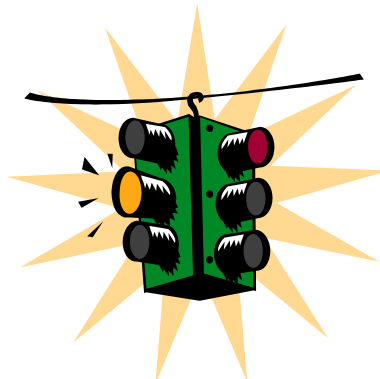
New Assessments and Accountability Provisions

- Grades 3-5, 6-9, 10-12 (In Washington grades 4,7,10)
 - Reading and math immediately
 - Science by 2007-2008
- Annual reading and math tests
 - Grades 3-8 by 2005-2006
- 95% participation rate
 - Students choosing not to take the test are assigned a “zero”
- Single Statewide Accountability System (levels of schools, district, state)
 - System of rewards and sanction
 - New definition of AYP
 - One other academic indicator required
 - Graduation rate at high school level
 - Unexcused absence rate at middle and elementary levels
 - “School improvement” status triggers teeth of law
 - Affects Title I set asides / allocations to schools
 - Important exception: Non-Title I served schools have no sanctions, except being identified as not meeting AYP
- Fiscal impact –
 - Ensure any use of public funds to encourage participation or good test scores is appropriate.
 - Plan for costs related to administration of additional assessments.
 - Need to understand fiscal implications of being identified for school improvement and plan accordingly.

Fiscal Implications of Being Identified for School Improvement

Transportation for Public School Choice (Sec. 1116(b)(E))

- Choice option must be offered in first year that school is identified for improvement
 - Parents must receive notice prior to first day of school year
- School obligation to pay transportation continues as long as the school is in school improvement. Choice option continues at parent option until the student has completed the highest grade available at school of choice.
- Another public school in district not identified as being in school improvement and not “persistently dangerous”
- Must give more than one option and take preference into consideration
- No lack of capacity – “the statute requires an LEA to take measure to overcome issues such as overcrowding, class size limits, and health and safety concerns.”
- Exceptions
 - All schools are identified for school improvement
 - One school building district
 - Rural or isolated
- Fiscal impact
 - Determining what amount to set-aside
 - Identifying and tracking costs (weighted cost per student less costs already being incurred to transport that child)



Supplemental Educational Services (sec 1116(b)(5)(B))

- Supplemental Educational Services must be offered in second year of being identified for school improvement (sec. 1116(b)(5)(B)) and continue until school is no longer in school improvement.
- Who is “eligible”?
 - Low income students only
 - Among eligible students, must rank in order of lowest achieving
- Who may be a provider?
 - OSPI develops list
 - For profit/nonprofit/religiously affiliated
 - ESD
 - Another district or school within the district not identified for school improvement
- Parent chooses, but LEA contracts with provider
- Funds for supplemental services is lesser of per pupil allocation or actual cost of services
- Fiscal impact – identifying costs should be fairly straightforward (invoices from SES providers), needs to be by student served



Set-asides for Transportation for Choice and Supplemental Educational Services (USDE Draft Non-Regulatory Guidance)

- Amount equal to 20% of district allocation (unless all requests satisfied with lesser amount)
 - Minimum of 5% for transportation for choice (if needed). Non supplant provisions apply.
 - Minimum of 5% for supplemental educational services (if needed).
 - Remaining 10% for either or both.
- Funding does not have to come from Title I, Part A, may be state or local moneys
- 20% cannot include administration related costs
- Up to 20% limits district's financial obligation for transportation for choice. If funds are insufficient to meet transportation needs, priority goes to lowest achieving students from low-income families, but choice must be offered to all (some without transportation if necessary.)
- Fiscal impact – tracking and accounting for set-asides
- Budget development prior to assessment results
- Budgets need to be flexible

Teacher Quality Accountability Requirements

- All states and districts are required to develop a plan describing how they will meet the timelines for teacher quality (all core academic subject teachers in the state highly qualified by the end of SY 2005-06) (sec. 1119(a)(2)).
 - Establish annual measurable objectives for each district and school
 - Must include an annual increase in the % of highly qualified teachers at each district and school that will result in meeting deadline (sec. 1119(a)(2)).
 - If districts do not meet the state-established benchmarks then specific actions must be taken:
 - At the end of the third year (SY 2004-05) under the state's plan, if a district has failed to make progress toward meeting the annual measurable objectives *and* has failed to make AYP for three consecutive years then
 - The state must enter into an agreement with the district on the use of the district's Title II, Part A funds (sec. 2141(c)), and
 - Ensure that the district does not hire new paraprofessional positions with Title I funds (with a few exceptions) (sec. sec. 2141(c)(2)).



Enforcement Outlook

- In the past the federal government had little enforcement
- Current administration is taking a harder line with enforcement activities
- Undersecretary Hickok has said that if states are out of compliance, federal funds will be withheld

What the Auditor will be focusing on

- The 2003 Compliance Supplement that was revised for NCLB does not address most of the new requirements.

What's not included:

- Teacher and parapro qualifications
- Data used for assessments and for reporting
- Earmarking requirements at the LEA level for schools in school improvement

What's included:

- New federal programs created under NCLB
- Transferability and other flexibility options

Focus:

- Focus on transferability and other flexibility options, including SEFA presentation
- Address earmarking requirements
- Wait for additional guidance before addressing data quality and “highly qualified” requirements
- Anticipate additional audit time for districts in school improvement and for newer programs.
- If and/or when direction is given by the feds to address “highly qualified” and data quality, this MAY require additional audit time.

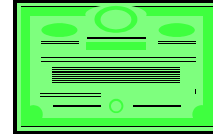




Audit Direction and Changes for FY03 Audits

1. Time and effort for schoolwides

- Semi-annual certifications are now required for employees charged 100% to schoolwides



2. Questioning Costs

- Indirect costs associated with questioned direct costs

Example: \$10,000 of direct costs are questioned in a time and effort finding. The district charged indirects to this grant using a rate of 3.5%. An additional \$350 ($\$10,000 \times 3.5\%$) of associated indirect charges would also be questioned.

3. Status of Prior Year Findings

- Prepared by school district, and audited by SAO
- If not fairly stated, A-133 states a finding must be reported

4. Medicaid Update

- No changes to how this is audited for FY03 audits.
- DSHS is holding meetings with school districts to determine whether changes to time studies or other requirements will be made.
- December 2003 is probable timeline for new decisions



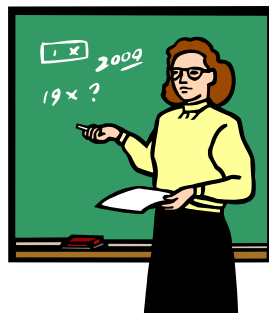
5. Federal focus

- 2003 Compliance Supplement makes subrecipient monitoring a core responsibility
- School lunch and verification – proposed changes to regulations

OIG Work Plan – Possible Audit Areas



- Quality Control Review (QCR) of A-133 Audits, OIG will conduct 100 QCRs of A-133 audits
- Schoolwide programs – what are states doing to encourage this fiscal flexibility
- Supplanting Funds – is this happening and if so, why
- E-Rate – joint project with FCC OIG
- Supplemental Services and Transportation Choice provisions under NCLB – are they being implemented
- SEA Audit Resolution – how are education program findings resolved by the SEA
- Transferability of funds – is this flexibility being used, if not, why
- Reading First
- Teacher Quality Program
- Bureau of Indian Affairs – Title I and Special Ed funds



Circular No. A-133 - Revised June 24, 1997
Audits of States, Local Governments, and Non-Profit Organizations

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Audits of States, Local Governments, and Non-Profit Organizations

1. **Purpose.** This Circular is issued pursuant to the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156. It sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of States, local governments, and non-profit organizations expending Federal awards.

2. **Authority.** Circular A-133 is issued under the authority of sections 503, 1111, and 7501 *et seq.* of title 31, United States Code, and Executive Orders 8248 and 11541.

3. **Rescission and Supersession.** This Circular rescinds Circular A-128, "Audits of State and Local Governments," issued April 12, 1985, and supersedes the prior Circular A-133, "Audits of Institutions of Higher Education and Other Non-Profit Institutions," issued April 22, 1996. For effective dates, see paragraph 10.

4. **Policy.** Except as provided herein, the standards set forth in this Circular shall be applied by all Federal agencies. If any statute specifically prescribes policies or specific requirements that differ from the standards provided herein, the provisions of the subsequent statute shall govern.

Federal agencies shall apply the provisions of the sections of this Circular to non-Federal entities, whether they are recipients expending Federal awards received directly from Federal awarding agencies, or are subrecipients expending Federal awards received from a pass-through entity (a recipient or another subrecipient).

This Circular does not apply to non-U.S. based entities expending Federal awards received either directly as a recipient or indirectly as a subrecipient.

5. **Definitions.** The definitions of key terms used in this Circular are contained in § ___.105 in the Attachment to this Circular.

6. **Required Action.** The specific requirements and responsibilities of Federal agencies and non-Federal entities are set forth in the Attachment to this Circular. Federal agencies making awards to non-Federal entities, either directly or indirectly, shall adopt the language in the Circular in codified regulations as provided in Section 10 (below), unless different provisions are required by Federal statute or are approved by the Office of Management and Budget (OMB).

7. **OMB Responsibilities.** OMB will review Federal agency regulations and implementation of this Circular, and will provide interpretations of policy requirements and assistance to ensure uniform, effective and efficient implementation.

8. **Information Contact.** Further information concerning Circular A-133 may be obtained by contacting the Financial Standards and Reporting Branch, Office of Federal Financial Management, Office of Management and Budget, Washington, DC 20503, telephone (202) 395-3993.

9. **Review Date.** This Circular will have a policy review three years from the date of issuance.

10. **Effective Dates.** The standards set forth in § ___.400 of the Attachment to this Circular, which apply directly to Federal agencies, shall be effective July 1, 1996, and shall apply to audits of fiscal years beginning after June 30, 1996, except as otherwise specified in § ___.400(a).

The standards set forth in this Circular that Federal agencies shall apply to non-Federal entities shall be adopted by Federal agencies in codified regulations not later than 60 days after publication of this final revision in the **Federal Register**, so that they will apply to audits of fiscal years beginning after June 30, 1996, with the exception that § ___.305(b) of the Attachment applies to audits of fiscal years beginning after June 30, 1998. The requirements of Circular A-128, although the Circular is rescinded, and the 1990 version of Circular A-133 remain in effect for audits of fiscal years beginning on or before June 30, 1996.

Franklin D. Raines
Director

Attachment

PART __ --AUDITS OF STATES, LOCAL GOVERNMENTS, AND NON-PROFIT ORGANIZATIONS

Subpart A--General
Sec.

- ___.100 Purpose.
- ___.105 Definitions.

Subpart B--Audits

- ___.200 Audit requirements.
- ___.205 Basis for determining Federal awards expended.
- ___.210 Subrecipient and vendor determinations.
- ___.215 Relation to other audit requirements.
- ___.220 Frequency of audits.
- ___.225 Sanctions.
- ___.230 Audit costs.
- ___.235 Program-specific audits.

Subpart C--Auditees

- ___.300 Auditee responsibilities.
- ___.305 Auditor selection.
- ___.310 Financial statements.
- ___.315 Audit findings follow-up.
- ___.320 Report submission.

Subpart D--Federal Agencies and Pass-Through Entities

- ___.400 Responsibilities.
- ___.405 Management decision.

Subpart E--Auditors

- ___.500 Scope of audit.
- ___.505 Audit reporting.
- ___.510 Audit findings.
- ___.515 Audit working papers.
- ___.520 Major program determination.
- ___.525 Criteria for Federal program risk.
- ___.530 Criteria for a low-risk auditee.

Appendix A to Part __ - Data Collection Form (Form SF-SAC).

Appendix B to Part __ - Circular A-133 Compliance Supplement.

Subpart A--General

§ ___.100 Purpose.

This part sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal awards.

§ ___.105 Definitions.

Auditee means any non-Federal entity that expends Federal awards which must be audited under this part. **Auditor** means an auditor, that is a public accountant or a Federal, State or local government audit organization, which meets the general standards specified in generally accepted government auditing standards (GAGAS). The term **auditor** does not include internal auditors of non-profit organizations.

Audit finding means deficiencies which the auditor is required by § __.510(a) to report in the schedule of findings and questioned costs.

CFDA number means the number assigned to a Federal program in the **Catalog of Federal Domestic Assistance** (CFDA).

Cluster of programs means a grouping of closely related programs that share common compliance requirements. The types of clusters of programs are research and development (R&D), student financial aid (SFA), and other clusters. "Other clusters" are as defined by the Office of Management and Budget (OMB) in the compliance supplement or as designated by a State for Federal awards the State provides to its subrecipients that meet the definition of a cluster of programs. When designating an "other cluster," a State shall identify the Federal awards included in the cluster and advise the subrecipients of compliance requirements applicable to the cluster, consistent with § __.400(d)(1) and § __.400(d)(2), respectively. A cluster of programs shall be considered as one program for determining major programs, as described in § __.520, and, with the exception of R&D as described in § __.200(c), whether a program-specific audit may be elected.

Cognizant agency for audit means the Federal agency designated to carry out the responsibilities described in § __.400(a).

Compliance supplement refers to the **Circular A-133 Compliance Supplement**, included as Appendix B to Circular A-133, or such documents as OMB or its designee may issue to replace it. This document is available from the Government Printing Office, Superintendent of Documents, Washington, DC 20402-9325.

Corrective action means action taken by the auditee that:

- (1) Corrects identified deficiencies;
- (2) Produces recommended improvements; or
- (3) Demonstrates that audit findings are either invalid or do not warrant auditee action.

Federal agency has the same meaning as the term **agency** in Section 551(1) of title 5, United States Code.

Federal award means Federal financial assistance and Federal cost-reimbursement contracts that non-Federal entities receive directly from Federal awarding agencies or indirectly from pass-through entities. It does not include procurement contracts, under grants or contracts, used to buy goods or services from vendors. Any audits of such vendors shall be covered by the terms and conditions of the contract. Contracts to operate Federal Government owned, contractor operated facilities (GOCOs) are excluded from the requirements of this part.

Federal awarding agency means the Federal agency that provides an award directly to the recipient.

Federal financial assistance means assistance that non-Federal entities receive or administer in the form of grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance, but does not include amounts received as reimbursement for services rendered to individuals as described in § __.205(h) and § __.205(i).

Federal program means:

- (1) All Federal awards to a non-Federal entity assigned a single number in the CFDA.
- (2) When no CFDA number is assigned, all Federal awards from the same agency made for the same purpose should be combined and considered one program.
- (3) Notwithstanding paragraphs (1) and (2) of this definition, a cluster of programs. The types of clusters of programs are:
 - (i) Research and development (R&D);
 - (ii) Student financial aid (SFA); and

(iii) "Other clusters," as described in the definition of cluster of programs in this section.

GAGAS means generally accepted government auditing standards issued by the Comptroller General of the United States, which are applicable to financial audits.

Generally accepted accounting principles has the meaning specified in generally accepted auditing standards issued by the American Institute of Certified Public Accountants (AICPA).

Indian tribe means any Indian tribe, band, nation, or other organized group or community, including any Alaskan Native village or regional or village corporation (as defined in, or established under, the Alaskan Native Claims Settlement Act) that is recognized by the United States as eligible for the special programs and services provided by the United States to Indians because of their status as Indians.

Internal control means a process, effected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- (1) Effectiveness and efficiency of operations;
- (2) Reliability of financial reporting; and
- (3) Compliance with applicable laws and regulations.

Internal control pertaining to the compliance requirements for Federal programs (Internal control over Federal programs) means a process--effected by an entity's management and other personnel--designed to provide reasonable assurance regarding the achievement of the following objectives for Federal programs:

(1) Transactions are properly recorded and accounted for to:

- (i) Permit the preparation of reliable financial statements and Federal reports;
- (ii) Maintain accountability over assets; and
- (iii) Demonstrate compliance with laws, regulations, and other compliance requirements;

(2) Transactions are executed in compliance with:

- (i) Laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on a Federal program; and
- (ii) Any other laws and regulations that are identified in the compliance supplement; and

(3) Funds, property, and other assets are safeguarded against loss from unauthorized use or disposition.

Loan means a Federal loan or loan guarantee received or administered by a non-Federal entity.

Local government means any unit of local government within a State, including a county, borough, municipality, city, town, township, parish, local public authority, special district, school district, intrastate district, council of governments, and any other instrumentality of local government.

Major program means a Federal program determined by the auditor to be a major program in accordance with § __.520 or a program identified as a major program by a Federal agency or pass-through entity in accordance with § __.215(c).

Management decision means the evaluation by the Federal awarding agency or pass-through entity of the audit findings and corrective action plan and the issuance of a written decision as to what corrective action is necessary.

Non-Federal entity means a State, local government, or non-profit organization.

Non-profit organization means:

- (1) any corporation, trust, association, cooperative, or other organization that:

- (i) Is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest;
 - (ii) Is not organized primarily for profit; and
 - (iii) Uses its net proceeds to maintain, improve, or expand its operations; and
- (2) The term **non-profit organization** includes non-profit institutions of higher education and hospitals.

OMB means the Executive Office of the President, Office of Management and Budget.

Oversight agency for audit means the Federal awarding agency that provides the predominant amount of direct funding to a recipient not assigned a cognizant agency for audit. When there is no direct funding, the Federal agency with the predominant indirect funding shall assume the oversight responsibilities. The duties of the oversight agency for audit are described in § __.400(b).

Pass-through entity means a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program.

Program-specific audit means an audit of one Federal program as provided for in § __.200(c) and § __.235.

Questioned cost means a cost that is questioned by the auditor because of an audit finding:

- (1) Which resulted from a violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of Federal funds, including funds used to match Federal funds;
- (2) Where the costs, at the time of the audit, are not supported by adequate documentation; or
- (3) Where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances.

Recipient means a non-Federal entity that expends Federal awards received directly from a Federal awarding agency to carry out a Federal program.

Research and development (R&D) means all research activities, both basic and applied, and all development activities that are performed by a non-Federal entity. **Research** is defined as a systematic study directed toward fuller scientific knowledge or understanding of the subject studied. The term research also includes activities involving the training of individuals in research techniques where such activities utilize the same facilities as other research and development activities and where such activities are not included in the instruction function. **Development** is the systematic use of knowledge and understanding gained from research directed toward the production of useful materials, devices, systems, or methods, including design and development of prototypes and processes.

Single audit means an audit which includes both the entity's financial statements and the Federal awards as described in § __.500.

State means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands, any instrumentality thereof, any multi-State, regional, or interstate entity which has governmental functions, and any Indian tribe as defined in this section.

Student Financial Aid (SFA) includes those programs of general student assistance, such as those authorized by Title IV of the Higher Education Act of 1965, as amended, (20 U.S.C. 1070 **et seq.**) which is administered by the U.S. Department of Education, and similar programs provided by other Federal agencies. It does not include programs which provide fellowships or similar Federal awards to students on a competitive basis, or for specified studies or research.

Subrecipient means a non-Federal entity that expends Federal awards received from a pass-through entity to carry out a Federal program, but does not include an individual that is a beneficiary of such a program. A subrecipient may also be a recipient of other Federal awards directly from a Federal awarding agency. Guidance on distinguishing between a subrecipient and a vendor is provided in § __.210.

Types of compliance requirements refers to the types of compliance requirements listed in the compliance supplement. Examples include: activities allowed or unallowed; allowable costs/cost principles; cash management; eligibility; matching; level of effort, earmarking; and, reporting.

Vendor means a dealer, distributor, merchant, or other seller providing goods or services that are required for the conduct of a Federal program. These goods or services may be for an organization's own use or for the use of beneficiaries of the Federal program. Additional guidance on distinguishing between a subrecipient and a vendor is provided in § ___.210.

Subpart B--Audits**§ ___.200 Audit requirements.**

(a) **Audit required.** Non-Federal entities that expend \$300,000 or more in a year in Federal awards shall have a single or program-specific audit conducted for that year in accordance with the provisions of this part. Guidance on determining Federal awards expended is provided in § ___.205.

(b) **Single audit.** Non-Federal entities that expend \$300,000 or more in a year in Federal awards shall have a single audit conducted in accordance with § ___.500 except when they elect to have a program-specific audit conducted in accordance with paragraph (c) of this section.

(c) **Program-specific audit election.** When an auditee expends Federal awards under only one Federal program (excluding R&D) and the Federal program's laws, regulations, or grant agreements do not require a financial statement audit of the auditee, the auditee may elect to have a program-specific audit conducted in accordance with § ___.235. A program-specific audit may not be elected for R&D unless all of the Federal awards expended were received from the same Federal agency, or the same Federal agency and the same pass-through entity, and that Federal agency, or pass-through entity in the case of a subrecipient, approves in advance a program-specific audit.

(d) **Exemption when Federal awards expended are less than \$300,000.** Non-Federal entities that expend less than \$300,000 a year in Federal awards are exempt from Federal audit requirements for that year, except as noted in § ___.215(a), but records must be available for review or audit by appropriate officials of the Federal agency, pass-through entity, and General Accounting Office (GAO).

(e) **Federally Funded Research and Development Centers (FFRDC).** Management of an auditee that owns or operates a FFRDC may elect to treat the FFRDC as a separate entity for purposes of this part.

§ ___.205 Basis for determining Federal awards expended.

(a) **Determining Federal awards expended.** The determination of when an award is expended should be based on when the activity related to the award occurs. Generally, the activity pertains to events that require the non-Federal entity to comply with laws, regulations, and the provisions of contracts or grant agreements, such as: expenditure/expense transactions associated with grants, cost-reimbursement contracts, cooperative agreements, and direct appropriations; the disbursement of funds passed through to subrecipients; the use of loan proceeds under loan and loan guarantee programs; the receipt of property; the receipt of surplus property; the receipt or use of program income; the distribution or consumption of food commodities; the disbursement of amounts entitling the non-Federal entity to an interest subsidy; and, the period when insurance is in force.

(b) **Loan and loan guarantees (loans).** Since the Federal Government is at risk for loans until the debt is repaid, the following guidelines shall be used to calculate the value of Federal awards expended under loan programs, except as noted in paragraphs (c) and (d) of this section:

- (1) Value of new loans made or received during the fiscal year; plus
- (2) Balance of loans from previous years for which the Federal Government imposes continuing compliance requirements; plus
- (3) Any interest subsidy, cash, or administrative cost allowance received.

(c) **Loan and loan guarantees (loans) at institutions of higher education.** When loans are made to students of an institution of higher education but the institution does not make the loans, then only the value of loans made during the year shall be considered Federal awards expended in that year. The balance of loans for previous years is not included as Federal awards expended because the lender accounts for the prior balances.

(d) **Prior loan and loan guarantees (loans).** Loans, the proceeds of which were received and expended in prior-years, are not considered Federal awards expended under this part when the laws, regulations, and the provisions of contracts or grant agreements pertaining to such loans impose no continuing compliance requirements other than to repay the loans.

(e) **Endowment funds.** The cumulative balance of Federal awards for endowment funds which are federally restricted are considered awards expended in each year in which the funds are still restricted.

(f) **Free rent.** Free rent received by itself is not considered a Federal award expended under this part. However, free rent received as part of an award to carry out a Federal program shall be included in determining Federal awards expended and subject to audit under this part.

(g) **Valuing non-cash assistance.** Federal non-cash assistance, such as free rent, food stamps, food commodities, donated property, or donated surplus property, shall be valued at fair market value at the time of receipt or the assessed value provided by the Federal agency.

(h) **Medicare.** Medicare payments to a non-Federal entity for providing patient care services to Medicare eligible individuals are not considered Federal awards expended under this part.

(i) **Medicaid.** Medicaid payments to a subrecipient for providing patient care services to Medicaid eligible individuals are not considered Federal awards expended under this part unless a State requires the funds to be treated as Federal awards expended because reimbursement is on a cost-reimbursement basis.

(j) **Certain loans provided by the National Credit Union Administration.** For purposes of this part, loans made from the National Credit Union Share Insurance Fund and the Central Liquidity Facility that are funded by contributions from insured institutions are not considered Federal awards expended.

§ __.210 Subrecipient and vendor determinations.

(a) **General.** An auditee may be a recipient, a subrecipient, and a vendor. Federal awards expended as a recipient or a subrecipient would be subject to audit under this part. The payments received for goods or services provided as a vendor would not be considered Federal awards. The guidance in paragraphs (b) and (c) of this section should be considered in determining whether payments constitute a Federal award or a payment for goods and services.

(b) **Federal award.** Characteristics indicative of a Federal award received by a subrecipient are when the organization:

- (1) Determines who is eligible to receive what Federal financial assistance;
- (2) Has its performance measured against whether the objectives of the Federal program are met;
- (3) Has responsibility for programmatic decision making;
- (4) Has responsibility for adherence to applicable Federal program compliance requirements; and
- (5) Uses the Federal funds to carry out a program of the organization as compared to providing goods or services for a program of the pass-through entity.

(c) **Payment for goods and services.** Characteristics indicative of a payment for goods and services received by a vendor are when the organization:

- (1) Provides the goods and services within normal business operations;
- (2) Provides similar goods or services to many different purchasers;
- (3) Operates in a competitive environment;
- (4) Provides goods or services that are ancillary to the operation of the Federal program; and
- (5) Is not subject to compliance requirements of the Federal program.

(d) **Use of judgment in making determination.** There may be unusual circumstances or exceptions to the listed characteristics. In making the determination of whether a subrecipient or vendor relationship exists, the substance of the relationship is more important than the form of the agreement. It is not expected that all of the characteristics will be present and judgment should be used in determining whether an entity is a subrecipient or vendor.

(e) **For-profit subrecipient.** Since this part does not apply to for-profit subrecipients, the pass-through entity is responsible for establishing requirements, as necessary, to ensure compliance by for-profit subrecipients. The contract with the for-profit subrecipient should describe applicable compliance requirements and the for-profit subrecipient's compliance responsibility. Methods to ensure compliance for Federal awards made to for-profit subrecipients may include pre-award audits, monitoring during the contract, and post-award audits.

(f) **Compliance responsibility for vendors.** In most cases, the auditee's compliance responsibility for vendors is only to ensure that the procurement, receipt, and payment for goods and services comply with laws, regulations, and the provisions of contracts or grant agreements. Program compliance requirements normally do not pass through to vendors. However, the auditee is responsible for ensuring compliance for vendor transactions which are structured such that the vendor is responsible for program compliance or the vendor's records must be reviewed to determine program compliance. Also, when these vendor transactions relate to a major program, the scope of the audit shall include determining whether these transactions are in compliance with laws, regulations, and the provisions of contracts or grant agreements.

§ __.215 Relation to other audit requirements.

(a) **Audit under this part in lieu of other audits.** An audit made in accordance with this part shall be in lieu of any financial audit required under individual Federal awards. To the extent this audit meets a Federal agency's needs, it shall rely upon and use such audits. The provisions of this part neither limit the authority of Federal agencies, including their Inspectors General, or GAO to conduct or arrange for additional audits (e.g., financial audits, performance audits, evaluations, inspections, or reviews) nor authorize any auditee to constrain Federal agencies from carrying out additional audits. Any additional audits shall be planned and performed in such a way as to build upon work performed by other auditors.

(b) **Federal agency to pay for additional audits.** A Federal agency that conducts or contracts for additional audits shall, consistent with other applicable laws and regulations, arrange for funding the full cost of such additional audits.

(c) **Request for a program to be audited as a major program.** A Federal agency may request an auditee to have a particular Federal program audited as a major program in lieu of the Federal agency conducting or arranging for the additional audits. To allow for planning, such requests should be made at least 180 days prior to the end of the fiscal year to be audited. The auditee, after consultation with its auditor, should promptly respond to such request by informing the Federal agency whether the program would otherwise be audited as a major program using the risk-based audit approach described in § __.520 and, if not, the estimated incremental cost. The Federal agency shall then promptly confirm to the auditee whether it wants the program audited as a major program. If the program is to be audited as a major program based upon this Federal agency request, and the Federal agency agrees to pay the full incremental costs, then the auditee shall have the program audited as a major program. A pass-through entity may use the provisions of this paragraph for a subrecipient.

§ __.220 Frequency of audits.

Except for the provisions for biennial audits provided in paragraphs (a) and (b) of this section, audits required by this part shall be performed annually. Any biennial audit shall cover both years within the biennial period.

(a) A State or local government that is required by constitution or statute, in effect on January 1, 1987, to undergo its audits less frequently than annually, is permitted to undergo its audits pursuant to this part biennially. This requirement must still be in effect for the biennial period under audit.

(b) Any non-profit organization that had biennial audits for all biennial periods ending between July 1, 1992, and January 1, 1995, is permitted to undergo its audits pursuant to this part biennially.

§ __.225 Sanctions.

No audit costs may be charged to Federal awards when audits required by this part have not been made or have been made but not in accordance with this part. In cases of continued inability or unwillingness to have an audit conducted in accordance with this part, Federal agencies and pass-through entities shall take appropriate action using sanctions such as:

(a) Withholding a percentage of Federal awards until the audit is completed satisfactorily;

(b) Withholding or disallowing overhead costs;

(c) Suspending Federal awards until the audit is conducted; or

(d) Terminating the Federal award.

§ __.230 Audit costs.

(a) **Allowable costs.** Unless prohibited by law, the cost of audits made in accordance with the provisions of this part are allowable charges to Federal awards. The charges may be considered a direct cost or an allocated indirect cost, as determined in accordance with the provisions of applicable OMB cost principles circulars, the Federal Acquisition Regulation (FAR) (48 CFR parts 30 and 31), or other applicable cost principles or regulations.

(b) **Unallowable costs.** A non-Federal entity shall not charge the following to a Federal award:

(1) The cost of any audit under the Single Audit Act Amendments of 1996 (31 U.S.C. 7501 **et seq.**) not conducted in accordance with this part.

(2) The cost of auditing a non-Federal entity which has Federal awards expended of less than \$300,000 per year and is thereby exempted under § __.200(d) from having an audit conducted under this part. However, this does not prohibit a pass-through entity from charging Federal awards for the cost of limited scope audits to monitor its subrecipients in accordance with § __.400(d)(3), provided the subrecipient does not have a single audit. For purposes of this part, limited scope audits only include agreed-upon procedures engagements conducted in accordance with either the AICPA's generally accepted auditing standards or attestation standards, that are paid for and arranged by a pass-through entity and address only one or more of the following types of compliance requirements: activities allowed or unallowed; allowable costs/cost principles; eligibility; matching, level of effort, earmarking; and, reporting.

§ __.235 Program-specific audits.

(a) **Program-specific audit guide available.** In many cases, a program-specific audit guide will be available to provide specific guidance to the auditor with respect to internal control, compliance requirements, suggested audit procedures, and audit reporting requirements. The auditor should contact the Office of Inspector General of the Federal agency to determine whether such a guide is available. When a current program-specific audit guide is available, the auditor shall follow GAGAS and the guide when performing a program-specific audit.

(b) **Program-specific audit guide not available.** (1) When a program-specific audit guide is not available, the auditee and auditor shall have basically the same responsibilities for the Federal program as they would have for an audit of a major program in a single audit.

(2) The auditee shall prepare the financial statement(s) for the Federal program that includes, at a minimum, a schedule of expenditures of Federal awards for the program and notes that describe the significant accounting policies used in preparing the schedule, a summary schedule of prior audit findings consistent with the requirements of § __.315(b), and a corrective action plan consistent with the requirements of § __.315(c).

(3) The auditor shall:

(i) Perform an audit of the financial statement(s) for the Federal program in accordance with GAGAS;

(ii) Obtain an understanding of internal control and perform tests of internal control over the Federal program consistent with the requirements of § __.500(c) for a major program;

(iii) Perform procedures to determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that could have a direct and material effect on the Federal program consistent with the requirements of § __.500(d) for a major program; and

(iv) Follow up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee, and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding in accordance with the requirements of § __.500(e).

(4) The auditor's report(s) may be in the form of either combined or separate reports and may be organized differently from the manner presented in this section. The auditor's report(s) shall state that the audit was conducted in accordance with this part and include the following:

(i) An opinion (or disclaimer of opinion) as to whether the financial statement(s) of the Federal program is presented fairly in all material respects in conformity with the stated accounting policies;

(ii) A report on internal control related to the Federal program, which shall describe the scope of testing of internal control and the results of the tests;

(iii) A report on compliance which includes an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on the Federal program; and

(iv) A schedule of findings and questioned costs for the Federal program that includes a summary of the auditor's results relative to the Federal program in a format consistent with § __.505(d)(1) and findings and questioned costs consistent with the requirements of § __.505(d)(3).

(c) Report submission for program-specific audits.

(1) The audit shall be completed and the reporting required by paragraph (c)(2) or (c)(3) of this section submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the Federal agency that provided the funding or a different period is specified in a program-specific audit guide. (However, for fiscal years beginning on or before June 30, 1998, the audit shall be completed and the required reporting shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or 13 months after the end of the audit period, unless a different period is specified in a program-specific audit guide.) Unless restricted by law or regulation, the auditee shall make report copies available for public inspection.

(2) When a program-specific audit guide is available, the auditee shall submit to the Federal clearinghouse designated by OMB the data collection form prepared in accordance with § __.320(b), as applicable to a program-specific audit, and the reporting required by the program-specific audit guide to be retained as an archival copy. Also, the auditee shall submit to the Federal awarding agency or pass-through entity the reporting required by the program-specific audit guide.

(3) When a program-specific audit guide is not available, the reporting package for a program-specific audit shall consist of the financial statement(s) of the Federal program, a summary schedule of prior audit findings, and a corrective action plan as described in paragraph (b)(2) of this section, and the auditor's report(s) described in paragraph (b)(4) of this section. The data collection form prepared in accordance with § __.320(b), as applicable to a program-specific audit, and one copy of this reporting package shall be submitted to the Federal clearinghouse designated by OMB to be retained as an archival copy. Also, when the schedule of findings and questioned costs disclosed audit findings or the summary schedule of prior audit findings reported the status of any audit findings, the auditee shall submit one copy of the reporting package to the Federal clearinghouse on behalf of the Federal awarding agency, or directly to the pass-through entity in the case of a subrecipient. Instead of submitting the reporting package to the pass-through entity, when a subrecipient is not required to submit a reporting package to the pass-through entity, the subrecipient shall provide written notification to the pass-through entity, consistent with the requirements of § __.320(e)(2). A subrecipient may submit a copy of the reporting package to the pass-through entity to comply with this notification requirement.

(d) **Other sections of this part may apply.** Program-specific audits are subject to § __.100 through § __.215(b), § __.220 through § __.230, § __.300 through § __.305, § __.315, § __.320(f) through § __.320(j), § __.400 through § __.405, § __.510 through § __.515, and other referenced provisions of this part unless contrary to the provisions of this section, a program-specific audit guide, or program laws and regulations.

Subpart C--Auditees

§ __.300 Auditee responsibilities.

The auditee shall:

(a) Identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity.

(b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs.

(c) Comply with laws, regulations, and the provisions of contracts or grant agreements related to each of its Federal programs.

(d) Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with § ___.310.

(e) Ensure that the audits required by this part are properly performed and submitted when due. When extensions to the report submission due date required by § ___.320(a) are granted by the cognizant or oversight agency for audit, promptly notify the Federal clearinghouse designated by OMB and each pass-through entity providing Federal awards of the extension.

(f) Follow up and take corrective action on audit findings, including preparation of a summary schedule of prior audit findings and a corrective action plan in accordance with § ___.315(b) and § ___.315(c), respectively.

§ ___.305 Auditor selection.

(a) **Auditor procurement.** In procuring audit services, auditees shall follow the procurement standards prescribed by the Grants Management Common Rule (hereinafter referred to as the "A-102 Common Rule") published March 11, 1988 and amended April 19, 1995 [insert appropriate CFR citation], Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations," or the FAR (48 CFR part 42), as applicable (OMB Circulars are available from the Office of Administration, Publications Office, room 2200, New Executive Office Building, Washington, DC 20503). Whenever possible, auditees shall make positive efforts to utilize small businesses, minority-owned firms, and women's business enterprises, in procuring audit services as stated in the A-102 Common Rule, OMB Circular A-110, or the FAR (48 CFR part 42), as applicable. In requesting proposals for audit services, the objectives and scope of the audit should be made clear. Factors to be considered in evaluating each proposal for audit services include the responsiveness to the request for proposal, relevant experience, availability of staff with professional qualifications and technical abilities, the results of external quality control reviews, and price.

(b) **Restriction on auditor preparing indirect cost proposals.** An auditor who prepares the indirect cost proposal or cost allocation plan may not also be selected to perform the audit required by this part when the indirect costs recovered by the auditee during the prior year exceeded \$1 million. This restriction applies to the base year used in the preparation of the indirect cost proposal or cost allocation plan and any subsequent years in which the resulting indirect cost agreement or cost allocation plan is used to recover costs. To minimize any disruption in existing contracts for audit services, this paragraph applies to audits of fiscal years beginning after June 30, 1998.

(c) **Use of Federal auditors.** Federal auditors may perform all or part of the work required under this part if they comply fully with the requirements of this part.

§ ___.310 Financial statements.

(a) **Financial statements.** The auditee shall prepare financial statements that reflect its financial position, results of operations or changes in net assets, and, where appropriate, cash flows for the fiscal year audited. The financial statements shall be for the same organizational unit and fiscal year that is chosen to meet the requirements of this part. However, organization-wide financial statements may also include departments, agencies, and other organizational units that have separate audits in accordance with § ___.500(a) and prepare separate financial statements.

(b) **Schedule of expenditures of Federal awards.** The auditee shall also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements. While not required, the auditee may choose to provide information requested by Federal awarding agencies and pass-through entities to make the schedule easier to use. For example, when a Federal program has multiple award years, the auditee may list the amount of Federal awards expended for each award year separately. At a minimum, the schedule shall:

(1) List individual Federal programs by Federal agency. For Federal programs included in a cluster of programs, list individual Federal programs within a cluster of programs. For R&D, total Federal awards expended shall be shown either by individual award or by Federal agency and major subdivision within the Federal agency. For example, the National Institutes of Health is a major subdivision in the Department of Health and Human Services.

(2) For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity shall be included.

(3) Provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available.

(4) Include notes that describe the significant accounting policies used in preparing the schedule.

(5) To the extent practical, pass-through entities should identify in the schedule the total amount provided to subrecipients from each Federal program.

(6) Include, in either the schedule or a note to the schedule, the value of the Federal awards expended in the form of non-cash assistance, the amount of insurance in effect during the year, and loans or loan guarantees outstanding at year end. While not required, it is preferable to present this information in the schedule.

§ __.315 Audit findings follow-up.

(a) **General.** The auditee is responsible for follow-up and corrective action on all audit findings. As part of this responsibility, the auditee shall prepare a summary schedule of prior audit findings. The auditee shall also prepare a corrective action plan for current year audit findings. The summary schedule of prior audit findings and the corrective action plan shall include the reference numbers the auditor assigns to audit findings under § __.510(c). Since the summary schedule may include audit findings from multiple years, it shall include the fiscal year in which the finding initially occurred.

(b) **Summary schedule of prior audit findings.** The summary schedule of prior audit findings shall report the status of all audit findings included in the prior audit's schedule of findings and questioned costs relative to Federal awards. The summary schedule shall also include audit findings reported in the prior audit's summary schedule of prior audit findings except audit findings listed as corrected in accordance with paragraph (b)(1) of this section, or no longer valid or not warranting further action in accordance with paragraph (b)(4) of this section.

(1) When audit findings were fully corrected, the summary schedule need only list the audit findings and state that corrective action was taken.

(2) When audit findings were not corrected or were only partially corrected, the summary schedule shall describe the planned corrective action as well as any partial corrective action taken.

(3) When corrective action taken is significantly different from corrective action previously reported in a corrective action plan or in the Federal agency's or pass-through entity's management decision, the summary schedule shall provide an explanation.

(4) When the auditee believes the audit findings are no longer valid or do not warrant further action, the reasons for this position shall be described in the summary schedule. A valid reason for considering an audit finding as not warranting further action is that all of the following have occurred:

(i) Two years have passed since the audit report in which the finding occurred was submitted to the Federal clearinghouse;

(ii) The Federal agency or pass-through entity is not currently following up with the auditee on the audit finding; and

(iii) A management decision was not issued.

(c) **Corrective action plan.** At the completion of the audit, the auditee shall prepare a corrective action plan to address each audit finding included in the current year auditor's reports. The corrective action plan shall provide the name(s) of the contact person(s) responsible for corrective action, the corrective action planned, and the anticipated completion date. If the auditee does not agree with the audit findings or believes corrective action is not required, then the corrective action plan shall include an explanation and specific reasons.

§ __.320 Report submission.

(a) **General.** The audit shall be completed and the data collection form described in paragraph (b) of this section and reporting package described in paragraph (c) of this section shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the cognizant or oversight agency for audit. (However, for fiscal years beginning on or before June 30, 1998, the audit shall be completed and the data collection form and reporting package shall be submitted within the earlier of 30 days after receipt of the auditor's report(s), or 13 months after the end of the audit period.) Unless restricted by law or regulation, the auditee shall make copies available for public inspection.

(b) **Data Collection.** (1) The auditee shall submit a data collection form which states whether the audit was completed in accordance with this part and provides information about the auditee, its Federal programs, and the results of the audit. The form shall be approved by OMB, available from the Federal clearinghouse designated by OMB, and include data elements similar to

those presented in this paragraph. A senior level representative of the auditee (e.g., State controller, director of finance, chief executive officer, or chief financial officer) shall sign a statement to be included as part of the form certifying that: the auditee complied with the requirements of this part, the form was prepared in accordance with this part (and the instructions accompanying the form), and the information included in the form, in its entirety, are accurate and complete.

(2) The data collection form shall include the following data elements:

- (i) The type of report the auditor issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).
- (ii) Where applicable, a statement that reportable conditions in internal control were disclosed by the audit of the financial statements and whether any such conditions were material weaknesses.
- (iii) A statement as to whether the audit disclosed any noncompliance which is material to the financial statements of the auditee.
- (iv) Where applicable, a statement that reportable conditions in internal control over major programs were disclosed by the audit and whether any such conditions were material weaknesses.
- (v) The type of report the auditor issued on compliance for major programs (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion).
- (vi) A list of the Federal awarding agencies which will receive a copy of the reporting package pursuant to § ___.320(d)(2) of OMB Circular A-133.
- (vii) A yes or no statement as to whether the auditee qualified as a low-risk auditee under § ___.530 of OMB Circular A-133.
- (viii) The dollar threshold used to distinguish between Type A and Type B programs as defined in § ___.520(b) of OMB Circular A-133.
- (ix) The **Catalog of Federal Domestic Assistance** (CFDA) number for each Federal program, as applicable.
- (x) The name of each Federal program and identification of each major program. Individual programs within a cluster of programs should be listed in the same level of detail as they are listed in the schedule of expenditures of Federal awards.
- (xi) The amount of expenditures in the schedule of expenditures of Federal awards associated with each Federal program.
- (xii) For each Federal program, a yes or no statement as to whether there are audit findings in each of the following types of compliance requirements and the total amount of any questioned costs:
 - (A) Activities allowed or unallowed.
 - (B) Allowable costs/cost principles.
 - (C) Cash management.
 - (D) Davis-Bacon Act.
 - (E) Eligibility.
 - (F) Equipment and real property management.
 - (G) Matching, level of effort, earmarking.
 - (H) Period of availability of Federal funds.
 - (I) Procurement and suspension and debarment.
 - (J) Program income.
 - (K) Real property acquisition and relocation assistance.
 - (L) Reporting.
 - (M) Subrecipient monitoring.
 - (N) Special tests and provisions.
- (xiii) Auditee Name, Employer Identification Number(s), Name and Title of Certifying Official, Telephone Number, Signature, and Date.
- (xiv) Auditor Name, Name and Title of Contact Person, Auditor Address, Auditor Telephone Number, Signature, and Date.
- (xv) Whether the auditee has either a cognizant or oversight agency for audit.

(xvi) The name of the cognizant or oversight agency for audit determined in accordance with § __.400(a) and § __.400(b), respectively.

(3) Using the information included in the reporting package described in paragraph (c) of this section, the auditor shall complete the applicable sections of the form. The auditor shall sign a statement to be included as part of the data collection form that indicates, at a minimum, the source of the information included in the form, the auditor's responsibility for the information, that the form is not a substitute for the reporting package described in paragraph (c) of this section, and that the content of the form is limited to the data elements prescribed by OMB.

(c) **Reporting package.** The reporting package shall include the:

- (1) Financial statements and schedule of expenditures of Federal awards discussed in § __.310(a) and § __.310(b), respectively;
- (2) Summary schedule of prior audit findings discussed in § __.315(b);
- (3) Auditor's report(s) discussed in § __.505; and
- (4) Corrective action plan discussed in § __.315(c).

(d) **Submission to clearinghouse.** All auditees shall submit to the Federal clearinghouse designated by OMB the data collection form described in paragraph (b) of this section and one copy of the reporting package described in paragraph (c) of this section for:

- (1) The Federal clearinghouse to retain as an archival copy; and
- (2) Each Federal awarding agency when the schedule of findings and questioned costs disclosed audit findings relating to Federal awards that the Federal awarding agency provided directly or the summary schedule of prior audit findings reported the status of any audit findings relating to Federal awards that the Federal awarding agency provided directly.

(e) **Additional submission by subrecipients.** (1) In addition to the requirements discussed in paragraph (d) of this section, auditees that are also subrecipients shall submit to each pass-through entity one copy of the reporting package described in paragraph (c) of this section for each pass-through entity when the schedule of findings and questioned costs disclosed audit findings relating to Federal awards that the pass-through entity provided or the summary schedule of prior audit findings reported the status of any audit findings relating to Federal awards that the pass-through entity provided.

(2) Instead of submitting the reporting package to a pass-through entity, when a subrecipient is not required to submit a reporting package to a pass-through entity pursuant to paragraph (e)(1) of this section, the subrecipient shall provide written notification to the pass-through entity that: an audit of the subrecipient was conducted in accordance with this part (including the period covered by the audit and the name, amount, and CFDA number of the Federal award(s) provided by the pass-through entity); the schedule of findings and questioned costs disclosed no audit findings relating to the Federal award(s) that the pass-through entity provided; and, the summary schedule of prior audit findings did not report on the status of any audit findings relating to the Federal award(s) that the pass-through entity provided. A subrecipient may submit a copy of the reporting package described in paragraph (c) of this section to a pass-through entity to comply with this notification requirement.

(f) **Requests for report copies.** In response to requests by a Federal agency or pass-through entity, auditees shall submit the appropriate copies of the reporting package described in paragraph (c) of this section and, if requested, a copy of any management letters issued by the auditor.

(g) **Report retention requirements.** Auditees shall keep one copy of the data collection form described in paragraph (b) of this section and one copy of the reporting package described in paragraph (c) of this section on file for three years from the date of submission to the Federal clearinghouse designated by OMB. Pass-through entities shall keep subrecipients' submissions on file for three years from date of receipt.

(h) **Clearinghouse responsibilities.** The Federal clearinghouse designated by OMB shall distribute the reporting packages received in accordance with paragraph (d)(2) of this section and § __.235(c)(3) to applicable Federal awarding agencies, maintain a data base of completed audits, provide appropriate information to Federal agencies, and follow up with known auditees which have not submitted the required data collection forms and reporting packages.

(i) **Clearinghouse address.** The address of the Federal clearinghouse currently designated by OMB is Federal Audit Clearinghouse, Bureau of the Census, 1201 E. 10th Street, Jeffersonville, IN 47132.

(j) **Electronic filing.** Nothing in this part shall preclude electronic submissions to the Federal clearinghouse in such manner as may be approved by OMB. With OMB approval, the Federal clearinghouse may pilot test methods of electronic submissions.

Subpart D--Federal Agencies and Pass-Through Entities
§__.400 Responsibilities.

(a) **Cognizant agency for audit responsibilities.** Recipients expending more than \$25 million a year in Federal awards shall have a cognizant agency for audit. The designated cognizant agency for audit shall be the Federal awarding agency that provides the predominant amount of direct funding to a recipient unless OMB makes a specific cognizant agency for audit assignment. To provide for continuity of cognizance, the determination of the predominant amount of direct funding shall be based upon direct Federal awards expended in the recipient's fiscal years ending in 1995, 2000, 2005, and every fifth year thereafter. For example, audit cognizance for periods ending in 1997 through 2000 will be determined based on Federal awards expended in 1995.

(However, for States and local governments that expend more than \$25 million a year in Federal awards and have previously assigned cognizant agencies for audit, the requirements of this paragraph are not effective until fiscal years beginning after June 30, 2000.) Notwithstanding the manner in which audit cognizance is determined, a Federal awarding agency with cognizance for an auditee may reassign cognizance to another Federal awarding agency which provides substantial direct funding and agrees to be the cognizant agency for audit. Within 30 days after any reassignment, both the old and the new cognizant agency for audit shall notify the auditee, and, if known, the auditor of the reassignment. The cognizant agency for audit shall:

- (1) Provide technical audit advice and liaison to auditees and auditors.
- (2) Consider auditee requests for extensions to the report submission due date required by §__.320(a). The cognizant agency for audit may grant extensions for good cause.
- (3) Obtain or conduct quality control reviews of selected audits made by non-Federal auditors, and provide the results, when appropriate, to other interested organizations.
- (4) Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any direct reporting by the auditee or its auditor of irregularities or illegal acts, as required by GAGAS or laws and regulations.
- (5) Advise the auditor and, where appropriate, the auditee of any deficiencies found in the audits when the deficiencies require corrective action by the auditor. When advised of deficiencies, the auditee shall work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency for audit shall notify the auditor, the auditee, and applicable Federal awarding agencies and pass-through entities of the facts and make recommendations for follow-up action. Major inadequacies or repetitive substandard performance by auditors shall be referred to appropriate State licensing agencies and professional bodies for disciplinary action.
- (6) Coordinate, to the extent practical, audits or reviews made by or for Federal agencies that are in addition to the audits made pursuant to this part, so that the additional audits or reviews build upon audits performed in accordance with this part.
- (7) Coordinate a management decision for audit findings that affect the Federal programs of more than one agency.
- (8) Coordinate the audit work and reporting responsibilities among auditors to achieve the most cost-effective audit.
- (9) For biennial audits permitted under §__.220, consider auditee requests to qualify as a low-risk auditee under §__.530(a).

(b) **Oversight agency for audit responsibilities.** An auditee which does not have a designated cognizant agency for audit will be under the general oversight of the Federal agency determined in accordance with §__.105. The oversight agency for audit:

- (1) Shall provide technical advice to auditees and auditors as requested.
- (2) May assume all or some of the responsibilities normally performed by a cognizant agency for audit.

(c) **Federal awarding agency responsibilities.** The Federal awarding agency shall perform the following for the Federal awards it makes:

- (1) Identify Federal awards made by informing each recipient of the CFDA title and number, award name and number, award year, and if the award is for R&D. When some of this information is not available, the Federal agency shall provide information necessary to clearly describe the Federal award.

- (2) Advise recipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements.
- (3) Ensure that audits are completed and reports are received in a timely manner and in accordance with the requirements of this part.
- (4) Provide technical advice and counsel to auditees and auditors as requested.
- (5) Issue a management decision on audit findings within six months after receipt of the audit report and ensure that the recipient takes appropriate and timely corrective action.
- (6) Assign a person responsible for providing annual updates of the compliance supplement to OMB.
- (d) **Pass-through entity responsibilities.** A pass-through entity shall perform the following for the Federal awards it makes:
 - (1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.
 - (2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.
 - (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.
 - (4) Ensure that subrecipients expending \$300,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.
 - (5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.
 - (6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.
 - (7) Require each subrecipient to permit the pass-through entity and auditors to have access to the records and financial statements as necessary for the pass-through entity to comply with this part.

§ __.405 Management decision.

- (a) **General.** The management decision shall clearly state whether or not the audit finding is sustained, the reasons for the decision, and the expected auditee action to repay disallowed costs, make financial adjustments, or take other action. If the auditee has not completed corrective action, a timetable for follow-up should be given. Prior to issuing the management decision, the Federal agency or pass-through entity may request additional information or documentation from the auditee, including a request for auditor assurance related to the documentation, as a way of mitigating disallowed costs. The management decision should describe any appeal process available to the auditee.
- (b) **Federal agency.** As provided in § __.400(a)(7), the cognizant agency for audit shall be responsible for coordinating a management decision for audit findings that affect the programs of more than one Federal agency. As provided in § __.400(c)(5), a Federal awarding agency is responsible for issuing a management decision for findings that relate to Federal awards it makes to recipients. Alternate arrangements may be made on a case-by-case basis by agreement among the Federal agencies concerned.
- (c) **Pass-through entity.** As provided in § __.400(d)(5), the pass-through entity shall be responsible for making the management decision for audit findings that relate to Federal awards it makes to subrecipients.
- (d) **Time requirements.** The entity responsible for making the management decision shall do so within six months of receipt of the audit report. Corrective action should be initiated within six months after receipt of the audit report and proceed as rapidly as possible.
- (e) **Reference numbers.** Management decisions shall include the reference numbers the auditor assigned to each audit finding in accordance with § __.510(c).

Subpart E--Auditors**§ __.500 Scope of audit.**

(a) **General.** The audit shall be conducted in accordance with GAGAS. The audit shall cover the entire operations of the auditee; or, at the option of the auditee, such audit shall include a series of audits that cover departments, agencies, and other organizational units which expended or otherwise administered Federal awards during such fiscal year, provided that each such audit shall encompass the financial statements and schedule of expenditures of Federal awards for each such department, agency, and other organizational unit, which shall be considered to be a non-Federal entity. The financial statements and schedule of expenditures of Federal awards shall be for the same fiscal year.

(b) **Financial statements.** The auditor shall determine whether the financial statements of the auditee are presented fairly in all material respects in conformity with generally accepted accounting principles. The auditor shall also determine whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the auditee's financial statements taken as a whole.

(c) **Internal control.** (1) In addition to the requirements of GAGAS, the auditor shall perform procedures to obtain an understanding of internal control over Federal programs sufficient to plan the audit to support a low assessed level of control risk for major programs.

(2) Except as provided in paragraph (c)(3) of this section, the auditor shall:

(i) Plan the testing of internal control over major programs to support a low assessed level of control risk for the assertions relevant to the compliance requirements for each major program; and

(ii) Perform testing of internal control as planned in paragraph (c)(2)(i) of this section.

(3) When internal control over some or all of the compliance requirements for a major program are likely to be ineffective in preventing or detecting noncompliance, the planning and performing of testing described in paragraph (c)(2) of this section are not required for those compliance requirements. However, the auditor shall report a reportable condition (including whether any such condition is a material weakness) in accordance with § __.510, assess the related control risk at the maximum, and consider whether additional compliance tests are required because of ineffective internal control.

(d) **Compliance.** (1) In addition to the requirements of GAGAS, the auditor shall determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs.

(2) The principal compliance requirements applicable to most Federal programs and the compliance requirements of the largest Federal programs are included in the compliance supplement.

(3) For the compliance requirements related to Federal programs contained in the compliance supplement, an audit of these compliance requirements will meet the requirements of this part. Where there have been changes to the compliance requirements and the changes are not reflected in the compliance supplement, the auditor shall determine the current compliance requirements and modify the audit procedures accordingly. For those Federal programs not covered in the compliance supplement, the auditor should use the types of compliance requirements contained in the compliance supplement as guidance for identifying the types of compliance requirements to test, and determine the requirements governing the Federal program by reviewing the provisions of contracts and grant agreements and the laws and regulations referred to in such contracts and grant agreements.

(4) The compliance testing shall include tests of transactions and such other auditing procedures necessary to provide the auditor sufficient evidence to support an opinion on compliance.

(e) **Audit follow-up.** The auditor shall follow-up on prior audit findings, perform procedures to assess the reasonableness of the summary schedule of prior audit findings prepared by the auditee in accordance with § __.315(b), and report, as a current year audit finding, when the auditor concludes that the summary schedule of prior audit findings materially misrepresents the status of any prior audit finding. The auditor shall perform audit follow-up procedures regardless of whether a prior audit finding relates to a major program in the current year.

(f) **Data Collection Form.** As required in § __.320(b)(3), the auditor shall complete and sign specified sections of the data collection form.

§ __.505 Audit reporting.

The auditor's report(s) may be in the form of either combined or separate reports and may be organized differently from the manner presented in this section. The auditor's report(s) shall state that the audit was conducted in accordance with this part and include the following:

(a) An opinion (or disclaimer of opinion) as to whether the financial statements are presented fairly in all material respects in conformity with generally accepted accounting principles and an opinion (or disclaimer of opinion) as to whether the schedule of expenditures of Federal awards is presented fairly in all material respects in relation to the financial statements taken as a whole.

(b) A report on internal control related to the financial statements and major programs. This report shall describe the scope of testing of internal control and the results of the tests, and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.

(c) A report on compliance with laws, regulations, and the provisions of contracts or grant agreements, noncompliance with which could have a material effect on the financial statements. This report shall also include an opinion (or disclaimer of opinion) as to whether the auditee complied with laws, regulations, and the provisions of contracts or grant agreements which could have a direct and material effect on each major program, and, where applicable, refer to the separate schedule of findings and questioned costs described in paragraph (d) of this section.

(d) A schedule of findings and questioned costs which shall include the following three components:

(1) A summary of the auditor's results which shall include:

(i) The type of report the auditor issued on the financial statements of the auditee (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion);

(ii) Where applicable, a statement that reportable conditions in internal control were disclosed by the audit of the financial statements and whether any such conditions were material weaknesses;

(iii) A statement as to whether the audit disclosed any noncompliance which is material to the financial statements of the auditee;

(iv) Where applicable, a statement that reportable conditions in internal control over major programs were disclosed by the audit and whether any such conditions were material weaknesses;

(v) The type of report the auditor issued on compliance for major programs (i.e., unqualified opinion, qualified opinion, adverse opinion, or disclaimer of opinion);

(vi) A statement as to whether the audit disclosed any audit findings which the auditor is required to report under § __.510(a);

(vii) An identification of major programs;

(viii) The dollar threshold used to distinguish between Type A and Type B programs, as described in § __.520(b); and

(ix) A statement as to whether the auditee qualified as a low-risk auditee under § __.530.

(2) Findings relating to the financial statements which are required to be reported in accordance with GAGAS.

(3) Findings and questioned costs for Federal awards which shall include audit findings as defined in § __.510(a).

(i) Audit findings (e.g., internal control findings, compliance findings, questioned costs, or fraud) which relate to the same issue should be presented as a single audit finding. Where practical, audit findings should be organized by Federal agency or pass-through entity.

(ii) Audit findings which relate to both the financial statements and Federal awards, as reported under paragraphs (d)(2) and (d)(3) of this section, respectively, should be reported in both sections of the schedule. However, the reporting in one section of the schedule may be in summary form with a reference to a detailed reporting in the other section of the schedule.

§ __.510 Audit findings.

(a) **Audit findings reported.** The auditor shall report the following as audit findings in a schedule of findings and questioned costs:

(1) Reportable conditions in internal control over major programs. The auditor's determination of whether a deficiency in internal control is a reportable condition for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the compliance supplement. The auditor shall identify reportable conditions which are individually or cumulatively material weaknesses.

(2) Material noncompliance with the provisions of laws, regulations, contracts, or grant agreements related to a major program. The auditor's determination of whether a noncompliance with the provisions of laws, regulations, contracts, or grant agreements is material for the purpose of reporting an audit finding is in relation to a type of compliance requirement for a major program or an audit objective identified in the compliance supplement.

(3) Known questioned costs which are greater than \$10,000 for a type of compliance requirement for a major program. Known questioned costs are those specifically identified by the auditor. In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the best estimate of total costs questioned (likely questioned costs), not just the questioned costs specifically identified (known questioned costs). The auditor shall also report known questioned costs when likely questioned costs are greater than \$10,000 for a type of compliance requirement for a major program. In reporting questioned costs, the auditor shall include information to provide proper perspective for judging the prevalence and consequences of the questioned costs.

(4) Known questioned costs which are greater than \$10,000 for a Federal program which is not audited as a major program. Except for audit follow-up, the auditor is not required under this part to perform audit procedures for such a Federal program; therefore, the auditor will normally not find questioned costs for a program which is not audited as a major program. However, if the auditor does become aware of questioned costs for a Federal program which is not audited as a major program (e.g., as part of audit follow-up or other audit procedures) and the known questioned costs are greater than \$10,000, then the auditor shall report this as an audit finding.

(5) The circumstances concerning why the auditor's report on compliance for major programs is other than an unqualified opinion, unless such circumstances are otherwise reported as audit findings in the schedule of findings and questioned costs for Federal awards.

(6) Known fraud affecting a Federal award, unless such fraud is otherwise reported as an audit finding in the schedule of findings and questioned costs for Federal awards. This paragraph does not require the auditor to make an additional reporting when the auditor confirms that the fraud was reported outside of the auditor's reports under the direct reporting requirements of GAGAS.

(7) Instances where the results of audit follow-up procedures disclosed that the summary schedule of prior audit findings prepared by the auditee in accordance with § __.315(b) materially misrepresents the status of any prior audit finding.

(b) **Audit finding detail.** Audit findings shall be presented in sufficient detail for the auditee to prepare a corrective action plan and take corrective action and for Federal agencies and pass-through entities to arrive at a management decision. The following specific information shall be included, as applicable, in audit findings:

(1) Federal program and specific Federal award identification including the CFDA title and number, Federal award number and year, name of Federal agency, and name of the applicable pass-through entity. When information, such as the CFDA title and number or Federal award number, is not available, the auditor shall provide the best information available to describe the Federal award.

(2) The criteria or specific requirement upon which the audit finding is based, including statutory, regulatory, or other citation.

(3) The condition found, including facts that support the deficiency identified in the audit finding.

(4) Identification of questioned costs and how they were computed.

(5) Information to provide proper perspective for judging the prevalence and consequences of the audit findings, such as whether the audit findings represent an isolated instance or a systemic problem. Where appropriate, instances identified shall be related to the universe and the number of cases examined and be quantified in terms of dollar value.

(6) The possible asserted effect to provide sufficient information to the auditee and Federal agency, or pass-through entity in the case of a subrecipient, to permit them to determine the cause and effect to facilitate prompt and proper corrective action.

- (7) Recommendations to prevent future occurrences of the deficiency identified in the audit finding.
- (8) Views of responsible officials of the auditee when there is disagreement with the audit findings, to the extent practical.
- (c) **Reference numbers.** Each audit finding in the schedule of findings and questioned costs shall include a reference number to allow for easy referencing of the audit findings during follow-up.

§ __.515 Audit working papers.

- (a) **Retention of working papers.** The auditor shall retain working papers and reports for a minimum of three years after the date of issuance of the auditor's report(s) to the auditee, unless the auditor is notified in writing by the cognizant agency for audit, oversight agency for audit, or pass-through entity to extend the retention period. When the auditor is aware that the Federal awarding agency, pass-through entity, or auditee is contesting an audit finding, the auditor shall contact the parties contesting the audit finding for guidance prior to destruction of the working papers and reports.
- (b) **Access to working papers.** Audit working papers shall be made available upon request to the cognizant or oversight agency for audit or its designee, a Federal agency providing direct or indirect funding, or GAO at the completion of the audit, as part of a quality review, to resolve audit findings, or to carry out oversight responsibilities consistent with the purposes of this part. Access to working papers includes the right of Federal agencies to obtain copies of working papers, as is reasonable and necessary.

§ __.520 Major program determination.

- (a) **General.** The auditor shall use a risk-based approach to determine which Federal programs are major programs. This risk-based approach shall include consideration of: Current and prior audit experience, oversight by Federal agencies and pass-through entities, and the inherent risk of the Federal program. The process in paragraphs (b) through (i) of this section shall be followed.
- (b) **Step 1.** (1) The auditor shall identify the larger Federal programs, which shall be labeled Type A programs. Type A programs are defined as Federal programs with Federal awards expended during the audit period exceeding the larger of:
- (i) \$300,000 or three percent (.03) of total Federal awards expended in the case of an auditee for which total Federal awards expended equal or exceed \$300,000 but are less than or equal to \$100 million.
- (ii) \$3 million or three-tenths of one percent (.003) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed \$100 million but are less than or equal to \$10 billion.
- (iii) \$30 million or 15 hundredths of one percent (.0015) of total Federal awards expended in the case of an auditee for which total Federal awards expended exceed \$10 billion.
- (2) Federal programs not labeled Type A under paragraph (b)(1) of this section shall be labeled Type B programs.
- (3) The inclusion of large loan and loan guarantees (loans) should not result in the exclusion of other programs as Type A programs. When a Federal program providing loans significantly affects the number or size of Type A programs, the auditor shall consider this Federal program as a Type A program and exclude its values in determining other Type A programs.
- (4) For biennial audits permitted under § __.220, the determination of Type A and Type B programs shall be based upon the Federal awards expended during the two-year period.
- (c) **Step 2.** (1) The auditor shall identify Type A programs which are low-risk. For a Type A program to be considered low-risk, it shall have been audited as a major program in at least one of the two most recent audit periods (in the most recent audit period in the case of a biennial audit), and, in the most recent audit period, it shall have had no audit findings under § __.510(a). However, the auditor may use judgment and consider that audit findings from questioned costs under § __.510(a)(3) and § __.510(a)(4), fraud under § __.510(a)(6), and audit follow-up for the summary schedule of prior audit findings under § __.510(a)(7) do not preclude the Type A program from being low-risk. The auditor shall consider: the criteria in § __.525(c), § __.525(d)(1), § __.525(d)(2), and § __.525(d)(3); the results of audit follow-up; whether any changes in personnel or systems affecting a Type A program have significantly increased risk; and apply professional judgment in determining whether a Type A program is low-risk.
- (2) Notwithstanding paragraph (c)(1) of this section, OMB may approve a Federal awarding agency's request that a Type A program at certain recipients may not be considered low-risk. For example, it may be necessary for a large Type A program to be audited as major each year at particular recipients to allow the Federal agency to comply with the Government Management

Reform Act of 1994 (31 U.S.C. 3515). The Federal agency shall notify the recipient and, if known, the auditor at least 180 days prior to the end of the fiscal year to be audited of OMB's approval.

(d) **Step 3.** (1) The auditor shall identify Type B programs which are high-risk using professional judgment and the criteria in § __.525. However, should the auditor select Option 2 under Step 4 (paragraph (e)(2)(i)(B) of this section), the auditor is not required to identify more high-risk Type B programs than the number of low-risk Type A programs. Except for known reportable conditions in internal control or compliance problems as discussed in § __.525(b)(1), § __.525(b)(2), and § __.525(c)(1), a single criteria in § __.525 would seldom cause a Type B program to be considered high-risk.

(2) The auditor is not expected to perform risk assessments on relatively small Federal programs. Therefore, the auditor is only required to perform risk assessments on Type B programs that exceed the larger of:

(i) \$100,000 or three-tenths of one percent (.003) of total Federal awards expended when the auditee has less than or equal to \$100 million in total Federal awards expended.

(ii) \$300,000 or three-hundredths of one percent (.0003) of total Federal awards expended when the auditee has more than \$100 million in total Federal awards expended.

(e) **Step 4.** At a minimum, the auditor shall audit all of the following as major programs:

(1) All Type A programs, except the auditor may exclude any Type A programs identified as low-risk under Step 2 (paragraph (c)(1) of this section).

(2) (i) High-risk Type B programs as identified under either of the following two options:

(A) **Option 1.** At least one half of the Type B programs identified as high-risk under Step 3 (paragraph (d) of this section), except this paragraph (e)(2)(i)(A) does not require the auditor to audit more high-risk Type B programs than the number of low-risk Type A programs identified as low-risk under Step 2.

(B) **Option 2.** One high-risk Type B program for each Type A program identified as low-risk under Step 2.

(ii) When identifying which high-risk Type B programs to audit as major under either Option 1 or 2 in paragraph (e)(2)(i)(A) or (B), the auditor is encouraged to use an approach which provides an opportunity for different high-risk Type B programs to be audited as major over a period of time.

(3) Such additional programs as may be necessary to comply with the percentage of coverage rule discussed in paragraph (f) of this section. This paragraph (e)(3) may require the auditor to audit more programs as major than the number of Type A programs.

(f) **Percentage of coverage rule.** The auditor shall audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 50 percent of total Federal awards expended. If the auditee meets the criteria in § __.530 for a low-risk auditee, the auditor need only audit as major programs Federal programs with Federal awards expended that, in the aggregate, encompass at least 25 percent of total Federal awards expended.

(g) **Documentation of risk.** The auditor shall document in the working papers the risk analysis process used in determining major programs.

(h) **Auditor's judgment.** When the major program determination was performed and documented in accordance with this part, the auditor's judgment in applying the risk-based approach to determine major programs shall be presumed correct. Challenges by Federal agencies and pass-through entities shall only be for clearly improper use of the guidance in this part. However, Federal agencies and pass-through entities may provide auditors guidance about the risk of a particular Federal program and the auditor shall consider this guidance in determining major programs in audits not yet completed.

(i) **Deviation from use of risk criteria.** For first-year audits, the auditor may elect to determine major programs as all Type A programs plus any Type B programs as necessary to meet the percentage of coverage rule discussed in paragraph (f) of this section. Under this option, the auditor would not be required to perform the procedures discussed in paragraphs (c), (d), and (e) of this section.

(1) A first-year audit is the first year the entity is audited under this part or the first year of a change of auditors.

(2) To ensure that a frequent change of auditors would not preclude audit of high-risk Type B programs, this election for first-year audits may not be used by an auditee more than once in every three years.

§ __.525 Criteria for Federal program risk.

(a) **General.** The auditor's determination should be based on an overall evaluation of the risk of noncompliance occurring which could be material to the Federal program. The auditor shall use auditor judgment and consider criteria, such as described in paragraphs (b), (c), and (d) of this section, to identify risk in Federal programs. Also, as part of the risk analysis, the auditor may wish to discuss a particular Federal program with auditee management and the Federal agency or pass-through entity.

(b) **Current and prior audit experience.** (1) Weaknesses in internal control over Federal programs would indicate higher risk. Consideration should be given to the control environment over Federal programs and such factors as the expectation of management's adherence to applicable laws and regulations and the provisions of contracts and grant agreements and the competence and experience of personnel who administer the Federal programs.

(i) A Federal program administered under multiple internal control structures may have higher risk. When assessing risk in a large single audit, the auditor shall consider whether weaknesses are isolated in a single operating unit (e.g., one college campus) or pervasive throughout the entity.

(ii) When significant parts of a Federal program are passed through to subrecipients, a weak system for monitoring subrecipients would indicate higher risk.

(iii) The extent to which computer processing is used to administer Federal programs, as well as the complexity of that processing, should be considered by the auditor in assessing risk. New and recently modified computer systems may also indicate risk.

(2) Prior audit findings would indicate higher risk, particularly when the situations identified in the audit findings could have a significant impact on a Federal program or have not been corrected.

(3) Federal programs not recently audited as major programs may be of higher risk than Federal programs recently audited as major programs without audit findings.

(c) **Oversight exercised by Federal agencies and pass-through entities.** (1) Oversight exercised by Federal agencies or pass-through entities could indicate risk. For example, recent monitoring or other reviews performed by an oversight entity which disclosed no significant problems would indicate lower risk. However, monitoring which disclosed significant problems would indicate higher risk.

(2) Federal agencies, with the concurrence of OMB, may identify Federal programs which are higher risk. OMB plans to provide this identification in the compliance supplement.

(d) **Inherent risk of the Federal program.** (1) The nature of a Federal program may indicate risk. Consideration should be given to the complexity of the program and the extent to which the Federal program contracts for goods and services. For example, Federal programs that disburse funds through third party contracts or have eligibility criteria may be of higher risk. Federal programs primarily involving staff payroll costs may have a high-risk for time and effort reporting, but otherwise be at low-risk.

(2) The phase of a Federal program in its life cycle at the Federal agency may indicate risk. For example, a new Federal program with new or interim regulations may have higher risk than an established program with time-tested regulations. Also, significant changes in Federal programs, laws, regulations, or the provisions of contracts or grant agreements may increase risk.

(3) The phase of a Federal program in its life cycle at the auditee may indicate risk. For example, during the first and last years that an auditee participates in a Federal program, the risk may be higher due to start-up or closeout of program activities and staff.

(4) Type B programs with larger Federal awards expended would be of higher risk than programs with substantially smaller Federal awards expended.

§ __.530 Criteria for a low-risk auditee.

An auditee which meets all of the following conditions for each of the preceding two years (or, in the case of biennial audits, preceding two audit periods) shall qualify as a low-risk auditee and be eligible for reduced audit coverage in accordance with § __.520:

(a) Single audits were performed on an annual basis in accordance with the provisions of this part. A non-Federal entity that has biennial audits does not qualify as a low-risk auditee, unless agreed to in advance by the cognizant or oversight agency for audit.

(b) The auditor's opinions on the financial statements and the schedule of expenditures of Federal awards were unqualified. However, the cognizant or oversight agency for audit may judge that an opinion qualification does not affect the management of Federal awards and provide a waiver.

(c) There were no deficiencies in internal control which were identified as material weaknesses under the requirements of GAGAS. However, the cognizant or oversight agency for audit may judge that any identified material weaknesses do not affect the management of Federal awards and provide a waiver.

(d) None of the Federal programs had audit findings from any of the following in either of the preceding two years (or, in the case of biennial audits, preceding two audit periods) in which they were classified as Type A programs:

(1) Internal control deficiencies which were identified as material weaknesses;

(2) Noncompliance with the provisions of laws, regulations, contracts, or grant agreements which have a material effect on the Type A program; or (3) Known or likely questioned costs that exceed five percent of the total Federal awards expended for a Type A program during the year.

Appendix A to Part __ - Data Collection Form (Form SF-SAC)

Appendix B to Part __ - Circular A-133 Compliance Supplement

Where Can I Find the Common Rule For My Grant?

Federal agencies are required to incorporate the common rule into their agency regulations as published in the Code of Federal Regulations (CFR). The Common Rule approach allows for uniformity so that grantees can refer to the same section number when discussing a particular grant administration concern. (See list of CFR references on page F-4).

When a federal agency implements the Common Rule, the section numbers (.01 through .52) follow the title and part of the agency's regulations in the CFR. For example, U.S. Department of Education (ED) regulations are found in Title 34 of the CFR. ED has implemented the Common Rule as Part 80 in Title 34 of the CFR. Therefore, ED's implementation of the Common Rule runs from 34 CFR 80.1 through 34 CFR 80.52. (See example on page D-3).

Federal Programs Excluded from the Common Rule

Certain grant programs are exempt from the provisions of the A-102 Common Rule.

For a current list of exempt programs, consult the OMB A-133 Compliance Supplement, Appendix I. This document is available on the OMB website.

Example of Common Rule for the Department of Education

[CITE: 34CFR80.25]

[Page 195-196]

TITLE 34--EDUCATION

PART 80--UNIFORM ADMINISTRATIVE REQUIREMENTS FOR GRANTS AND COOPERATIVE AGREEMENTS TO STATE AND LOCAL GOVERNMENTS--Table of Contents

Subpart C--Post-Award Requirements

Sec. 80.25 Program income.

(a) General. Grantees are encouraged to earn income to defray program costs. Program income includes income from fees for services performed, from the use or rental of real or personal property acquired with grant funds, from the sale of commodities or items fabricated under a grant agreement, and from payments of principal and interest on loans made with grant funds. Except as otherwise provided in regulations of the Federal agency, program income does not include interest on grant funds, rebates, credits, discounts, refunds, etc. and interest earned on any of them.

(b) Definition of program income. Program income means gross income received by the grantee or subgrantee directly generated by a grant supported activity, or earned only as a result of the grant agreement during the grant period. ``During the grant period'' is the time between the effective date of the award and the ending date of the award reflected in the final financial report.

(c) Cost of generating program income. If authorized by Federal regulations or the grant agreement, costs incident to the generation of program income may be deducted from gross income to determine program income.

(d) Governmental revenues. Taxes, special assessments, levies, fines, and other such revenues raised by a grantee or subgrantee are not program income unless the revenues are specifically identified in the grant agreement or Federal agency regulations as program income.

(e) Royalties. Income from royalties and license fees for copyrighted material, patents, and inventions developed by a grantee or subgrantee is program income only if the revenues are specifically identified in the grant agreement or Federal agency regulations as program income. (See Sec. 80.34.)

(f) Property. Proceeds from the sale of real property or equipment will be handled in accordance with the requirements of Secs. 80.31 and 80.32.

(g) Use of program income. Program income shall be deducted from outlays which may be both Federal and non-Federal as described below, unless the Federal agency regulations or the grant agreement specify another alternative (or a combination of the alternatives). In specifying alternatives, the Federal agency may distinguish between income earned by the grantee and income earned by subgrantees and between the sources, kinds, or amounts of income. When Federal agencies authorize the alternatives in paragraphs (g) (2) and (3) of this section, program income in excess of any limits stipulated shall also be deducted from outlays.

Common Rule CFR Listing of Various Federal Agencies

Corporation for National and Community Service	45 CFR 2541
Department of Agriculture	7 CFR 3015, 3016
Department of Commerce	15 CFR 24
Department of Defense	32 CFR 33
Department of Education	34 CFR 80
Department of Energy	10 CFR 600
Department of Health and Human Services	45 CFR 92
Department of Housing and Urban Development	24 CFR 85
Department of the Interior	43 CFR 12
Department of Justice	28 CFR 66
Department of Labor	29 CFR 97
Department of State	22 CFR 135
Department of Transportation	49 CFR 18
Department of Veterans Affairs	38 CFR 43
Environmental Protection Agency	40 CFR 31
Federal Emergency Management Agency	44 CFR 13
Federal Mediation and Conciliation Service	29 CFR 1470
General Services Administration	41 CFR 105-71
Institute of Museum Services	45 CFR 1183
National Archives and Records Administration	36 CFR 1207
National Council on Disability	41 CFR 105-71
National Drug Control Policy Office	21 CFR 1403
National Endowment for the Arts	45 CFR 1157
National Endowment for the Humanities	45 CFR 1174
National Science Foundation	45 CFR 602
Small Business Administration	13 CFR 143

Federal Cost Principles/A-87

The Office of Management and Budget (OMB) has established cost principles that define allowable costs under various federal grant programs for different types of grantees. These principles are outlined in the following OMB documents:

- OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*;
- OMB Circular A-21, *Cost Principles for Educational Institutions*; and
- OMB Circular A- 122, *Cost Principles for Non-Profit Organizations*.

All three sets of cost principles share the same purpose – to provide principles for determining the allowable costs of federal grants contracts and other agreements incurred by educational institutions, non-profit organizations, and state, local and Indian tribal governments.

The principles are designed to provide that the federal government "bear its fair share" of the costs associated with federal awards. They do not address provisions for profit.

August 29, 1997

MEMORANDUM FOR THE RECORD**FROM:** Norwood J. Jackson
Deputy Controller

Office of Federal Financial Management

SUBJECT: Recompilation of OMB Circular A-87

I certify that the attached document constitutes a recompilation of Office of Management and Budget Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments." The recompilation consists of the last complete revision of the Circular published at 60 FR 26484 (dated May 4, 1995, published May 17, 1995), as further amended at 62 FR 45934 (August 29, 1997).

OMB CIRCULAR A-87 (REVISED 5/4/95, As Further Amended 8/29/97)
CIRCULAR NO. A-87
Revised

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Cost Principles for State, Local, and Indian Tribal Governments

1. Purpose. This Circular establishes principles and standards for determining costs for Federal awards carried out through grants, cost reimbursement contracts, and other agreements with State and local governments and federally-recognized Indian tribal governments (governmental units).
2. Authority. This Circular is issued under the authority of the Budget and Accounting Act of 1921, as amended; the Budget and Accounting Procedures Act of 1950, as amended; the Chief Financial Officers Act of 1990; Reorganization Plan No. 2 of 1970; and Executive Order No. 11541 ("Prescribing the Duties of the Office of Management and Budget and the Domestic Policy Council in the Executive Office of the President").
3. Background. An interagency task force was established in 1987 to review existing cost principles for Federal awards to State, local, and Indian tribal governments. The task force studied Inspector General reports and recommendations, solicited suggestions for changes to the Circular from governmental units, and compared for consistency the provisions of other OMB cost principles circulars covering non-profit organizations and universities. A proposed revised Circular reflecting the results of those efforts was issued on October 12, 1988, and August 19, 1993. Extensive comments on the proposed revisions, discussions with interest groups, and related developments were considered in developing this revision.
4. Rescissions. This Circular rescinds and supersedes Circular A-87, issued January 15, 1981.
5. Policy. This Circular establishes principles and standards to provide a uniform approach for determining costs and to promote effective program delivery, efficiency, and better relationships between governmental units and the Federal Government. The principles are for determining allowable costs only. They are not intended to identify the circumstances or to dictate the extent of Federal and governmental unit participation in the financing of a particular Federal award. Provision for profit or other increment above cost is outside the scope of this Circular.
6. Definitions. Definitions of key terms used in this Circular are contained in Attachment A, Section B.
7. Required Action. Agencies responsible for administering programs that involve cost reimbursement contracts, grants, and other agreements with governmental units shall issue codified regulations to implement the provisions of this Circular and its Attachments by September 1, 1995.
8. OMB Responsibilities. The Office of Management and Budget (OMB) will review agency regulations and implementation of this Circular, and will provide policy interpretations and assistance to insure effective and efficient implementation. Any exceptions will be subject to approval by OMB. Exceptions will only be made in particular cases where adequate justification is presented.
9. Information Contact. Further information concerning this Circular may be obtained by contacting the Office of Federal Financial Management, Financial Standards and Reporting Branch, Office of Management and Budget, Washington, DC 20503, telephone 202-395-3993.
10. Policy Review Date. OMB Circular A-87 will have a policy review three years from the date of issuance.
11. Effective Date. This Circular is effective as follows:

- For costs charged indirectly or otherwise covered by the cost allocation plans described in Attachments C, D and E, this revision shall be applied to cost allocation plans and indirect cost proposals submitted or prepared for a governmental unit's fiscal year that begins on or after September 1, 1995.

- For other costs, this revision shall be applied to all awards or amendments, including continuation or renewal awards, made on or after September 1, 1995.

Attachments

OMB CIRCULAR NO. A-87

COST PRINCIPLES FOR STATE, LOCAL AND INDIAN TRIBAL GOVERNMENTS

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ATTACHMENT A
Circular No. A-87

GENERAL PRINCIPLES FOR DETERMINING ALLOWABLE COSTS

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A. Purpose and Scope

1. Objectives. This Attachment establishes principles for determining the allowable costs incurred by State, local, and federally-recognized Indian tribal governments (governmental units) under grants, cost reimbursement contracts, and other agreements with the Federal Government (collectively referred to in this Circular as "Federal awards"). The principles are for the purpose of cost determination and are not intended to identify the circumstances or dictate the extent of Federal or governmental unit participation in the financing of a particular program or project. The principles are designed to provide that Federal awards bear their fair share of cost recognized under these principles except where restricted or prohibited by law. Provision for profit or other increment above cost is outside the scope of this Circular.

2. Policy guides.

a. The application of these principles is based on the fundamental premises that:

(1) Governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices.

(2) Governmental units assume responsibility for administering Federal funds in a manner consistent with underlying agreements, program objectives, and the terms and conditions of the Federal award.

(3) Each governmental unit, in recognition of its own unique combination of staff, facilities, and experience, will have the primary responsibility for employing whatever form of organization and management techniques may be necessary to assure proper and efficient administration of Federal awards.

b. Federal agencies should work with States or localities which wish to test alternative mechanisms for paying costs for administering Federal programs. The Office of Management and Budget (OMB) encourages Federal agencies to test fee-for-service alternatives as a replacement for current cost-reimbursement payment methods in response to the National Performance Review's (NPR) recommendation. The NPR recommended the fee-for-service approach to reduce the burden associated with maintaining systems for charging administrative costs to Federal programs and preparing and approving cost allocation plans. This approach should also increase incentives for administrative efficiencies and improve outcomes.

3. Application.

a. These principles will be applied by all Federal agencies in determining costs incurred by governmental units under Federal awards (including subawards) except those with (1) publicly-financed educational institutions subject to OMB Circular A-21, "Cost Principles for Educational Institutions," and (2) programs administered by publicly-owned hospitals and other providers of medical care that are subject to requirements promulgated by the sponsoring Federal agencies. However, this Circular does apply to all central service and department/agency costs that are allocated or billed to those educational institutions, hospitals, and other providers of medical care or services by other State and local government departments and agencies.

b. All subawards are subject to those Federal cost principles applicable to the particular organization concerned. Thus, if a subaward is to a governmental unit (other than a college, university or hospital), this Circular shall apply; if a subaward is to a commercial organization, the cost principles applicable to commercial organizations shall apply; if

a subaward is to a college or university, Circular A-21 shall apply; if a subaward is to a hospital, the cost principles used by the Federal awarding agency for awards to hospitals shall apply, subject to the provisions of subsection A.3.a. of this Attachment; if a subaward is to some other non-profit organization, Circular A-122, "Cost Principles for Non-Profit Organizations," shall apply.

c. These principles shall be used as a guide in the pricing of fixed price arrangements where costs are used in determining the appropriate price.

d. Where a Federal contract awarded to a governmental unit incorporates a Cost Accounting Standards (CAS) clause, the requirements of that clause shall apply. In such cases, the governmental unit and the cognizant Federal agency shall establish an appropriate advance agreement on how the governmental unit will comply with applicable CAS requirements when estimating, accumulating and reporting costs under CAS-covered contracts. The agreement shall indicate that OMB Circular A-87 requirements will be applied to other Federal awards. In all cases, only one set of records needs to be maintained by the governmental unit.

e. Conditional exemptions.

(1) OMB authorizes conditional exemption from OMB administrative requirements and cost principles circulars for certain Federal programs with statutorily-authorized consolidated planning and consolidated administrative funding, that are identified by a Federal agency and approved by the head of the Executive department or establishment. A Federal agency shall consult with OMB during its consideration of whether to grant such an exemption.

(2) To promote efficiency in State and local program administration, when Federal non-entitlement programs with common purposes have specific statutorily-authorized consolidated planning and consolidated administrative funding and where most of the State agency's resources come from non-Federal sources, Federal agencies may exempt these covered State-administered, non-entitlement grant programs from certain OMB grants management requirements. The exemptions would be from all but the allocability of costs provisions of OMB Circulars A-87 (Attachment A, subsection C.3), "Cost Principles for State, Local, and Indian Tribal Governments," A-21 (Section C, subpart 4), "Cost Principles for Educational Institutions," and A-122 (Attachment A, subsection A.4), "Cost Principles for Non-Profit Organizations," and from all of the administrative requirements provisions of OMB Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations," and the agencies' grants management common rule.

(3) When a Federal agency provides this flexibility, as a prerequisite to a State's exercising this option, a State must adopt its own written fiscal and administrative requirements for expending and accounting for all funds, which are consistent with the provisions of OMB Circular A-87, and extend such policies to all subrecipients. These fiscal and administrative requirements must be sufficiently specific to ensure that: funds are used in compliance with all applicable Federal statutory and regulatory provisions, costs are reasonable and necessary for operating these programs, and funds are not be used for general expenses required to carry out other responsibilities of a State or its subrecipients.

B. Definitions

1. "Approval or authorization of the awarding or cognizant Federal agency" means documentation evidencing consent prior to incurring a specific cost. If such costs are specifically identified in a Federal award document, approval of the document constitutes approval of the costs. If the costs are covered by a State/local-wide cost allocation plan or an indirect cost proposal, approval of the plan constitutes the approval.

2. "Award" means grants, cost reimbursement contracts and other agreements between a State, local and Indian tribal government and the Federal Government.

3. "Awarding agency" means (a) with respect to a grant, cooperative agreement, or cost reimbursement contract, the Federal agency, and (b) with respect to a subaward, the party that awarded the subaward.

4. "Central service cost allocation plan" means the documentation identifying, accumulating, and allocating or developing billing rates based on the allowable costs of services provided by a governmental unit on a centralized basis to its departments and agencies. The costs of these services may be allocated or billed to users.

5. "Claim" means a written demand or written assertion by the governmental unit or grantor seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of award terms, or other relief arising under or relating to the award. A voucher, invoice or other routine request for payment that is not a dispute when submitted is not a claim. Appeals, such as those filed by a governmental unit in response to questioned audit costs, are not considered claims until a final management decision is made by the Federal awarding agency.

6. "Cognizant agency" means the Federal agency responsible for reviewing, negotiating, and approving cost allocation plans or indirect cost proposals developed under this Circular on behalf of all Federal agencies. OMB publishes a listing of cognizant agencies.

7. "Common Rule" means the "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments; Final Rule" originally issued at 53 FR 8034-8103 (March 11, 1988). Other common rules will be referred to by their specific titles.

8. "Contract" means a mutually binding legal relationship obligating the seller to furnish the supplies or services (including construction) and the buyer to pay for them. It includes all types of commitments that obligate the government to an expenditure of appropriated funds and that, except as otherwise authorized, are in writing. In addition to bilateral instruments, contracts include (but are not limited to): awards and notices of awards; job orders or task orders issued under basic ordering agreements; letter contracts; orders, such as purchase orders, under which the contract becomes effective by written acceptance or performance; and, bilateral contract modifications. Contracts do not include grants and cooperative agreements covered by 31 U.S.C. 6301 et seq.

9. "Cost" means an amount as determined on a cash, accrual, or other basis acceptable to the Federal awarding or cognizant agency. It does not include transfers to a general or similar fund.

10. "Cost allocation plan" means central service cost allocation plan, public assistance cost allocation plan, and indirect cost rate proposal. Each of these terms are further defined in this section.

11. "Cost objective" means a function, organizational subdivision, contract, grant, or other activity for which cost data are needed and for which costs are incurred.

12. "Federally-recognized Indian tribal government" means the governing body or a governmental agency of any Indian tribe, band, nation, or other organized group or community (including any native village as defined in Section 3 of the Alaska Native Claims Settlement Act, 85 Stat. 688) certified by the Secretary of the Interior as eligible for the special programs and services provided through the Bureau of Indian Affairs.

13. "Governmental unit" means the entire State, local, or federally-recognized Indian tribal government, including any component thereof. Components of governmental units may function independently of the governmental unit in accordance with the term of the award.

14. "Grantee department or agency" means the component of a State, local, or federally-recognized Indian tribal government which is responsible for the performance or administration of all or some part of a Federal award.

15. "Indirect cost rate proposal" means the documentation prepared by a governmental unit or component thereof to substantiate its request for the establishment of an indirect cost rate as described in Attachment E of this Circular.

16. "Local government" means a county, municipality, city, town, township, local public authority, school district, special district, intrastate district, council of governments (whether or not incorporated as a non-profit corporation under State law), any other regional or interstate government entity, or any agency or instrumentality of a local government.

17. "Public assistance cost allocation plan" means a narrative description of the procedures that will be used in identifying, measuring and allocating all administrative costs to all of the programs administered or supervised by State public assistance agencies as described in Attachment D of this Circular.

18. "State" means any of the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any agency or instrumentality of a State exclusive of local governments.

C. Basic Guidelines

1. Factors affecting allowability of costs. To be allowable under Federal awards, costs must meet the following general criteria:

- a. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.
- b. Be allocable to Federal awards under the provisions of this Circular.
- c. Be authorized or not prohibited under State or local laws or regulations.

d. Conform to any limitations or exclusions set forth in these principles, Federal laws, terms and conditions of the Federal award, or other governing regulations as to types or amounts of cost items.

e. Be consistent with policies, regulations, and procedures that apply uniformly to both Federal awards and other activities of the governmental unit.

f. Be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.

g. Except as otherwise provided for in this Circular, be determined in accordance with generally accepted accounting principles.

h. Not be included as a cost or used to meet cost sharing or matching requirements of any other Federal award in either the current or a prior period, except as specifically provided by Federal law or regulation.

i. Be the net of all applicable credits.

j. Be adequately documented.

2. Reasonable costs. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the cost. The question of reasonableness is particularly important when governmental units or components are predominately federally-funded. In determining reasonableness of a given cost, consideration shall be given to:

a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the governmental unit or the performance of the Federal award.

b. The restraints or requirements imposed by such factors as: sound business practices; arms length bargaining; Federal, State and other laws and regulations; and, terms and conditions of the Federal award.

c. Market prices for comparable goods or services.

d. Whether the individuals concerned acted with prudence in the circumstances considering their responsibilities to the governmental unit, its employees, the public at large, and the Federal Government.

e. Significant deviations from the established practices of the governmental unit which may unjustifiably increase the Federal award's cost.

3. Allocable costs.

a. A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received.

b. All activities which benefit from the governmental unit's indirect cost, including unallowable activities and services donated to the governmental unit by third parties, will receive an appropriate allocation of indirect costs.

c. Any cost allocable to a particular Federal award or cost objective under the principles provided for in this Circular may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons. However, this prohibition would not preclude governmental units from shifting costs that are allowable under two or more awards in accordance with existing program agreements.

d. Where an accumulation of indirect costs will ultimately result in charges to a Federal award, a cost allocation plan will be required as described in Attachments C, D, and E.

4. Applicable credits.

a. Applicable credits refer to those receipts or reduction of expenditure-type transactions that offset or reduce expense items allocable to Federal awards as direct or indirect costs. Examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds or rebates, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing to or received by the governmental unit relate to allowable costs, they shall be credited to the Federal award either as a cost reduction or cash refund, as appropriate.

b. In some instances, the amounts received from the Federal Government to finance activities or service operations of the governmental unit should be treated as applicable credits. Specifically, the concept of netting such credit items

(including any amounts used to meet cost sharing or matching requirements) should be recognized in determining the rates or

amounts to be charged to Federal awards. (See Attachment B, item 15, "Depreciation and use allowances," for areas of potential application in the matter of Federal financing of activities.)

D. Composition of Cost

1. Total cost. The total cost of Federal awards is comprised of the allowable direct cost of the program, plus its allocable portion of allowable indirect costs, less applicable credits.

2. Classification of costs. There is no universal rule for classifying certain costs as either direct or indirect under every accounting system. A cost may be direct with respect to some specific service or function, but indirect with respect to the Federal award or other final cost objective. Therefore, it is essential that each item of cost be treated consistently in like circumstances either as a direct or an indirect cost. Guidelines for determining direct and indirect costs charged to Federal awards are provided in the sections that follow.

E. Direct Costs

1. General. Direct costs are those that can be identified specifically with a particular final cost objective.

2. Application. Typical direct costs chargeable to Federal awards are:

- a. Compensation of employees for the time devoted and identified specifically to the performance of those awards.
- b. Cost of materials acquired, consumed, or expended specifically for the purpose of those awards.
- c. Equipment and other approved capital expenditures.
- d. Travel expenses incurred specifically to carry out the award.

3. Minor items. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where such accounting treatment for that item of cost is consistently applied to all cost objectives.

F. Indirect Costs

1. General. Indirect costs are those: (a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefitted, without effort disproportionate to the results achieved. The term "indirect costs," as used herein, applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services, and facilities. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a governmental unit department. Indirect cost pools should be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived.

2. Cost allocation plans and indirect cost proposals. Requirements for development and submission of cost allocation plans and indirect cost rate proposals are contained in Attachments C, D, and E.

3. Limitation on indirect or administrative costs.

a. In addition to restrictions contained in this Circular, there may be laws that further limit the amount of administrative or indirect cost allowed.

b. Amounts not recoverable as indirect costs or administrative costs under one Federal award may not be shifted to another Federal award, unless specifically authorized by Federal legislation or regulation.

G. Interagency Services. The cost of services provided by one agency to another within the governmental unit may include allowable direct costs of the service plus a pro rate share of indirect costs. A standard indirect cost allowance equal to ten percent of the direct salary and wage cost of providing the service (excluding overtime, shift premiums, and fringe benefits) may be used in lieu of determining the actual indirect costs of the service. These services do not include centralized services included in central service cost allocation plans as described in Attachment C.

H. Required Certifications. Each cost allocation plan or indirect cost rate proposal required by Attachments C and E must comply with the following:

1. No proposal to establish a cost allocation plan or an indirect cost rate, whether submitted to a Federal cognizant agency or maintained on file by the governmental unit, shall be acceptable unless such costs have been certified by the governmental unit using the Certificate of Cost Allocation Plan or Certificate of Indirect Costs as set forth in Attachments C and E. The certificate must be signed on behalf of the governmental unit by an individual at a level no lower than chief financial officer of the governmental unit that submits the proposal or component covered by the proposal.

2. No cost allocation plan or indirect cost rate shall be approved by the Federal Government unless the plan or rate proposal has been certified. Where it is necessary to establish a cost allocation plan or an indirect cost rate and the governmental unit has not submitted a certified proposal for establishing such a plan or rate in accordance with the requirements, the Federal Government may either disallow all indirect costs or unilaterally establish such a plan or rate. Such a plan or rate may be based upon audited historical data or such other data that have been furnished to the cognizant Federal agency and for which it can be demonstrated that all unallowable costs have been excluded. When a cost allocation plan or indirect cost rate is unilaterally established by the Federal Government because of failure of the governmental unit to submit a certified proposal, the plan or rate established will be set to ensure that potentially unallowable costs will not be reimbursed.

ATTACHMENT B
Circular No. A-87

SELECTED ITEMS OF COST

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30. Memberships, subscriptions, and professional activities
31. Motor pools
32. Pre-award costs
33. Professional service costs
34. Proposal costs
35. Publication and printing costs
36. Rearrangements and alterations
37. Reconversion costs
38. Rental costs
39. Taxes
40. Training
41. Travel costs
42. Underrecovery of costs under Federal agreements

Sections 1 through 42 provide principles to be applied in establishing the allowability or unallowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect. A cost is allowable for Federal reimbursement only to the extent of benefits received by Federal awards and its conformance with the general policies and principles stated in Attachment A to this Circular. Failure to mention a particular item of cost in these sections is not intended to imply that it is either allowable or unallowable; rather, determination of allowability in each

case should be based on the treatment or standards provided for similar or related items of cost.

1. Accounting. The cost of establishing and maintaining accounting and other information systems is allowable.

2. Advertising and public relations costs.

a. The term "advertising costs" means the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, exhibits, and the like.

b. The term "public relations" includes community relations and means those activities dedicated to maintaining the image of the governmental unit or maintaining or promoting understanding and favorable relations with the community or public at large or any segment of the public.

c. Advertising costs are allowable only when incurred for the recruitment of personnel, the procurement of goods and services, the disposal of surplus materials, and any other specific purposes necessary to meet the requirements of the Federal award. Advertising costs associated with the disposal of surplus materials are not allowable where all disposal costs are reimbursed based on a standard rate as specified in the grants management common rule.

d. Public relations costs are allowable when:

(1) Specifically required by the Federal award and then only as a direct cost;

(2) Incurred to communicate with the public and press pertaining to specific activities or accomplishments that result from performance of the Federal award and then only as a direct cost; or

(3) Necessary to conduct general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary to keep the public informed on matters of public concern, such as notices of Federal contract/grant awards, financial matters, etc.

e. Unallowable advertising and public relations costs include the following:

(1) All advertising and public relations costs other than as specified in subsections c. and d.;

(2) Except as otherwise permitted by these cost principles, costs of conventions, meetings, or other events related to other activities of the governmental unit including:

(a) Costs of displays, demonstrations, and exhibits;

(b) Costs of meeting rooms, hospitality suites, and other special facilities used in conjunction with shows and other special events; and

(c) Salaries and wages of employees engaged in setting up and displaying exhibits, making demonstrations, and providing briefings;

(3) Costs of promotional items and memorabilia, including models, gifts, and souvenirs; and

(4) Costs of advertising and public relations designed solely to promote the governmental unit.

3. Advisory councils. Costs incurred by advisory councils or committees are allowable as a direct cost where authorized by the Federal awarding agency or as an indirect cost where allocable to Federal awards.

4. Alcoholic beverages. Costs of alcoholic beverages are unallowable.

5. Audit services. The costs of audits are allowable provided that the audits were performed in accordance with the Single Audit Act, as implemented by Circular A-128, "Audits of State and Local Governments." [Note: In June 1997, OMB rescinded Circular A-128 and co-located all audit requirements in a re-titled Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations."] Generally, the percentage of costs charged to Federal awards for a single audit shall not exceed the percentage derived by dividing Federal funds expended by total funds expended by the recipient or subrecipient (including program matching funds) during the fiscal year. The percentage may be exceeded only if appropriate documentation demonstrates higher actual costs.

Other audit costs are allowable if specifically approved by the awarding or cognizant agency as a direct cost to an award or included as an indirect cost in a cost allocation plan or rate.

6. Automatic electronic data processing. The cost of data processing services is allowable (but see section 19, Equipment and other capital expenditures).

7. Bad debts. Any losses arising from uncollectible accounts and other claims, and related costs, are unallowable unless provided for in Federal program award regulations.

8. Bonding costs. Costs of bonding employees and officials are allowable to the extent that such bonding is in accordance with sound business practice.

9. Budgeting. Costs incurred for the development, preparation, presentation, and execution of budgets are allowable.

10. Communications. Costs of telephone, mail, messenger, and similar communication services are allowable.

11. Compensation for personnel services.

a. General. Compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under Federal awards, including but not necessarily limited to wages, salaries, and fringe benefits. The costs of such compensation are allowable to the extent that they satisfy the specific requirements of this Circular, and that the total compensation for individual employees:

(1) Is reasonable for the services rendered and conforms to the established policy of the governmental unit consistently applied to both Federal and non-Federal activities;

(2) Follows an appointment made in accordance with a governmental unit's laws and rules and meets merit system or other requirements required by Federal law, where applicable; and

(3) Is determined and supported as provided in subsection h.

b. Reasonableness. Compensation for employees engaged in work on Federal awards will be considered reasonable to the extent that it is consistent with that paid for similar work in other activities of the governmental unit. In cases where the kinds of employees required for Federal awards are not found in the other activities of the governmental unit, compensation will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor market in which the employing government competes for the kind of employees involved. Compensation surveys providing data representative of the labor market involved will be an acceptable basis for evaluating reasonableness.

c. Unallowable costs. Costs which are unallowable under other sections of these principles shall not be allowable under this section solely on the basis that they constitute personnel compensation.

d. Fringe benefits.

(1) Fringe benefits are allowances and services provided by employers to their employees as compensation in addition to regular salaries and wages. Fringe benefits include, but are not limited to, the costs of leave, employee insurance, pensions, and unemployment benefit plans. Except as provided elsewhere in these principles, the costs of fringe benefits are allowable to the extent that the benefits are reasonable and are required by law, governmental unit-employee agreement, or an established policy of the governmental unit.

(2) The cost of fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, sick leave, holidays, court leave, military leave, and other similar benefits, are allowable if: (a) they are provided under established written leave policies; (b) the costs are equitably allocated to all related activities, including Federal awards; and, (c) the accounting basis (cash or accrual) selected for costing each type of leave is consistently followed by the governmental unit.

(3) When a governmental unit uses the cash basis of accounting, the cost of leave is recognized in the period that the leave is taken and paid for. Payments for unused leave when an employee retires or terminates employment are allowable in the year of payment provided they are allocated as a general administrative expense to all activities of the governmental unit or component.

(4) The accrual basis may be only used for those types of leave for which a liability as defined by Generally Accepted Accounting Principles (GAAP) exists when the leave is earned. When a governmental unit uses the accrual basis of accounting, in accordance with GAAP, allowable leave costs are the lesser of the amount accrued or funded.

(5) The cost of fringe benefits in the form of employer contributions or expenses for social security; employee life, health, unemployment, and worker's compensation insurance (except as indicated in section 25, Insurance and indemnification); pension plan costs (see subsection e.); and other similar benefits are allowable, provided such

benefits are granted under established written policies. Such benefits, whether treated as indirect costs or as direct costs, shall be allocated to Federal awards and all other activities in a manner consistent with the pattern of benefits attributable to the individuals or group(s) of employees whose salaries and wages are chargeable to such Federal awards and other activities.

e. Pension plan costs. Pension plan costs may be computed using a pay-as-you-go method or an acceptable actuarial cost method in accordance with established written policies of the governmental unit.

(1) For pension plans financed on a pay-as-you-go method, allowable costs will be limited to those representing actual payments to retirees or their beneficiaries.

(2) Pension costs calculated using an actuarial cost-based method recognized by GAAP are allowable for a given fiscal year if they are funded for that year within six months after the end of that year. Costs funded after the six month period (or a later period agreed to by the cognizant agency) are allowable in the year funded. The cognizant agency may agree to an extension of the six month period if an appropriate adjustment is made to compensate for the timing of the charges to the Federal Government and related Federal reimbursement and the governmental unit's contribution to the pension fund. Adjustments may be made by cash refund or other equitable procedures to compensate the Federal Government for the time value of Federal reimbursements in excess of contributions to the pension fund.

(3) Amounts funded by the governmental unit in excess of the actuarially determined amount for a fiscal year may be used as the governmental unit's contribution in future periods.

(4) When a governmental unit converts to an acceptable actuarial cost method, as defined by GAAP, and funds pension costs in accordance with this method, the unfunded liability at the time of conversion shall be allowable if amortized over a period of years in accordance with GAAP.

(5) The Federal Government shall receive an equitable share of any previously allowed pension costs (including earnings thereon) which revert or inure to the governmental unit in the form of a refund, withdrawal, or other credit.

f. Post-retirement health benefits. Post-retirement health benefits (PRHB) refers to costs of health insurance or health services not included in a pension plan covered by subsection e. for retirees and their spouses, dependents, and survivors. PRHB costs may be computed using a pay-as-you-go method or an acceptable actuarial cost method in accordance with established written policies of the governmental unit.

(1) For PRHB financed on a pay as-you-go method, allowable costs will be limited to those representing actual payments to retirees or their beneficiaries.

(2) PRHB costs calculated using an actuarial cost method recognized by GAAP are allowable if they are funded for that year within six months after the end of that year. Costs funded after the six month period (or a later period agreed to by the cognizant agency) are allowable in the year funded. The cognizant agency may agree to an extension of the six month period if an appropriate adjustment is made to compensate for the timing of the charges to the Federal Government and related Federal reimbursements and the governmental unit's contributions to the PRHB fund. Adjustments may be made by cash refund, reduction in current year's PRHB costs, or other equitable procedures to compensate the Federal Government for the time value of Federal reimbursements in excess of contributions to the PRHB fund.

(3) Amounts funded in excess of the actuarially determined amount for a fiscal year may be used as the government's contribution in a future period.

(4) When a governmental unit converts to an acceptable actuarial cost method and funds PRHB costs in accordance with this method, the initial unfunded liability attributable to prior years shall be allowable if amortized over a period of years in accordance with GAAP, or, if no such GAAP period exists, over a period negotiated with the cognizant agency.

(5) To be allowable in the current year, the PRHB costs must be paid either to:

(a) An insurer or other benefit provider as current year costs or premiums, or

(b) An insurer or trustee to maintain a trust fund or reserve for the sole purpose of providing post-retirement benefits to retirees and other beneficiaries.

(6) The Federal Government shall receive an equitable share of any amounts of previously allowed post-retirement benefit costs (including earnings thereon) which revert or inure to the governmental unit in the form of a refund, withdrawal, or other credit.

g. Severance pay.

(1) Payments in addition to regular salaries and wages made to workers whose employment is being terminated are allowable to the extent that, in each case, they are required by (a) law, (b) employer-employee agreement, or (c) established written policy.

(2) Severance payments (but not accruals) associated with normal turnover are allowable. Such payments shall be allocated to all activities of the governmental unit as an indirect cost.

(3) Abnormal or mass severance pay will be considered on a case-by-case basis and is allowable only if approved by the cognizant Federal agency.

h. Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.

(1) Charges to Federal awards for salaries and wages, whether treated as direct or indirect costs, will be based on payrolls documented in accordance with generally accepted practice of the governmental unit and approved by a responsible official(s) of the governmental unit.

(2) No further documentation is required for the salaries and wages of employees who work in a single indirect cost activity.

(3) Where employees are expected to work solely on a single Federal award or cost objective, charges for their salaries and wages will be supported by periodic certifications that the employees worked solely on that program for the period covered by the certification. These certifications will be prepared at least semi-annually and will be signed by the employee or supervisory official having first hand knowledge of the work performed by the employee.

(4) Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation which meets the standards in subsection (5) unless a statistical sampling system (see subsection (6)) or other substitute system has been approved by the cognizant Federal agency. Such documentary support will be required where employees work on:

(a) More than one Federal award,

(b) A Federal award and a non-Federal award,

(c) An indirect cost activity and a direct cost activity,

(d) Two or more indirect activities which are allocated using different allocation bases, or

(e) An unallowable activity and a direct or indirect cost activity.

(5) Personnel activity reports or equivalent documentation must meet the following standards:

(a) They must reflect an after-the-fact distribution of the actual activity of each employee,

(b) They must account for the total activity for which each employee is compensated,

(c) They must be prepared at least monthly and must coincide with one or more pay periods, and

(d) They must be signed by the employee.

(e) Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards but may be used for interim accounting purposes, provided that:

(i) The governmental unit's system for establishing the estimates produces reasonable approximations of the activity actually performed;

(ii) At least quarterly, comparisons of actual costs to budgeted distributions based on the monthly activity reports are made. Costs charged to Federal awards to reflect adjustments made as a result of the activity actually performed may be recorded annually if the quarterly comparisons show the differences between budgeted and actual costs are less than ten percent; and

(iii) The budget estimates or other distribution percentages are revised at least quarterly, if necessary, to reflect changed circumstances.

(6) Substitute systems for allocating salaries and wages to Federal awards may be used in place of activity reports. These systems are subject to approval if required by the cognizant agency. Such systems may include, but are not limited to, random moment sampling, case counts, or other quantifiable measures of employee effort.

(a) Substitute systems which use sampling methods (primarily for Aid to Families with Dependent Children (AFDC), Medicaid, and other public assistance programs) must meet acceptable statistical sampling standards including:

(i) The sampling universe must include all of the employees whose salaries and wages are to be allocated based on sample results except as provided in subsection (c);

(ii) The entire time period involved must be covered by the sample; and

(iii) The results must be statistically valid and applied to the period being sampled.

(b) Allocating charges for the sampled employees' supervisors, clerical and support staffs, based on the results of the sampled employees, will be acceptable.

(c) Less than full compliance with the statistical sampling standards noted in subsection (a) may be accepted by the cognizant agency if it concludes that the amounts to be allocated to Federal awards will be minimal, or if it concludes that the system proposed by the governmental unit will result in lower costs to Federal awards than a system which complies with the standards.

(7) Salaries and wages of employees used in meeting cost sharing or matching requirements of Federal awards must be supported in the same manner as those claimed as allowable costs under Federal awards.

i. Donated services.

(1) Donated or volunteer services may be furnished to a governmental unit by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost. However, the value of donated services may be used to meet cost sharing or matching requirements in accordance with the provisions of the Common Rule.

(2) The value of donated services utilized in the performance of a direct cost activity shall, when material in amount, be considered in the determination of the governmental unit's indirect costs or rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs.

(3) To the extent feasible, donated services will be supported by the same methods used by the governmental unit to support the allocability of regular personnel services.

12. Contingencies. Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, or intensity, or with an assurance of their happening, are unallowable. The term "contingency reserve" excludes self-insurance reserves (see subsection 25.c.), pension plan reserves (see subsection 11.e.), and post-retirement health and other benefit reserves (see subsection 11.f.) computed using acceptable actuarial cost methods.

13. Contributions and donations. Contributions and donations, including cash, property, and services, by governmental units to others, regardless of the recipient, are unallowable.

14. Defense and prosecution of criminal and civil proceedings, and claims.

a. The following costs are unallowable for contracts covered by 10 U.S.C. 2324(k), "Allowable costs under defense contracts."

(1) Costs incurred in defense of any civil or criminal fraud proceeding or similar proceeding (including filing of false certification brought by the United States where the contractor is found liable or has pleaded nolo contendere to a charge of fraud or similar proceeding (including filing of a false certification)).

(2) Costs incurred by a contractor in connection with any criminal, civil or administrative proceedings commenced by the United States or a State to the extent provided in 10 U.S.C. 2324(k).

b. Legal expenses required in the administration of Federal programs are allowable. Legal expenses for prosecution of claims against the Federal Government are unallowable.

15. Depreciation and use allowances.

a. Depreciation and use allowances are means of allocating the cost of fixed assets to periods benefitting from asset use. Compensation for the use of fixed assets on hand may be made through depreciation or use allowances. A combination of the two methods may not be used in connection with a single class of fixed assets (e.g., buildings, office equipment, computer equipment, etc.) except as provided in subsection g. Except for enterprise funds and internal service funds that are included as part of a State/local cost allocation plan, classes of assets shall be determined on the same basis used for the government-wide financial statements.

b. The computation of depreciation or use allowances shall be based on the acquisition cost of the assets involved. Where actual cost records have not been maintained, a reasonable estimate of the original acquisition cost may be used. The value of an asset donated to the governmental unit by an unrelated third party shall be its fair market value at the time of donation. Governmental or quasi-governmental organizations located within the same State shall not be considered unrelated third parties for this purpose.

c. The computation of depreciation or use allowances will exclude:

(1) The cost of land;

(2) Any portion of the cost of buildings and equipment borne by or donated by the Federal Government irrespective of where title was originally vested or where it presently resides; and

(3) Any portion of the cost of buildings and equipment contributed by or for the governmental unit, or a related donor organization, in satisfaction of a matching requirement.

d. Where the use allowance method is followed, the use allowance for buildings and improvements (including land improvements, such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition costs. The use allowance for equipment will be computed at an annual rate not exceeding 6 2/3 percent of acquisition cost. When the use allowance method is used for buildings, the entire building must be treated as a single asset; the building's components (e.g., plumbing system, heating and air condition, etc.) cannot be segregated from the building's shell. The two percent limitation, however, need not be applied to equipment which is merely attached or fastened to the building but not permanently fixed to it and which is used as furnishings or decorations or for specialized purposes (e.g., dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, modular furniture, carpeting, etc.). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the destruction of, or need for costly or extensive alterations or repairs, to the building or the equipment. Equipment that meets these criteria will be subject to the 6 2/3 percent equipment use allowance limitation.

e. Where the depreciation method is followed, the period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, historical usage patterns, technological developments, and the renewal and replacement policies of the governmental unit followed for the individual items or classes of assets involved. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater in the early portions than in the later portions of its useful life, the straight line method of depreciation shall be used. Depreciation methods once used shall not be changed unless approved by the Federal cognizant or awarding agency. When the depreciation method is introduced for application to an asset previously subject to a use allowance, the annual depreciation charge thereon may not exceed the amount that would have resulted had the depreciation method been in effect from the date of acquisition of the asset. The combination of use allowances and depreciation applicable to the asset shall not exceed the total acquisition cost of the asset or fair market value at time of donation.

f. When the depreciation method is used for buildings, a building's shell may be segregated from the major component of the building (e.g., plumbing system, heating, and air conditioning system, etc.) and each major component depreciated over its estimated useful life, or the entire building (i.e., the shell and all components) may be treated as a single asset and depreciated over a single useful life.

g. A reasonable use allowance may be negotiated for any assets that are considered to be fully depreciated, after taking into consideration the amount of depreciation previously charged to the government, the estimated useful life remaining at the time of negotiation, the effect of any increased maintenance charges, decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.

h. Charges for use allowances or depreciation must be supported by adequate property records. Physical inventories must be taken at least once every two years (a statistical sampling approach is acceptable) to ensure that assets exist, and are in use. Governmental units will manage equipment in accordance with State laws and procedures. When the depreciation method is followed, depreciation records indicating the amount of depreciation taken each period must also be maintained.

16. Disbursing service. The cost of disbursing funds by the Treasurer or other designated officer is allowable.

17. Employee morale, health, and welfare costs. The costs of health or first-aid clinics and/or infirmaries, recreational facilities, employee counseling services, employee information publications, and any related expenses incurred in accordance with a governmental unit's policy are allowable. Income generated from any of these activities will be offset against expenses.

18. Entertainment. Costs of entertainment, including amusement, diversion, and social activities and any costs directly associated with such costs (such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities) are unallowable.

19. Equipment and other capital expenditures.

a. As used in this section the following terms have the meanings as set forth below:

(1) "Capital expenditure" means the cost of the asset including the cost to put it in place. Capital expenditure for equipment means the net invoice price of the equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protective in transit insurance, freight, and installation may be included in, or excluded from, capital expenditure cost in accordance with the governmental unit's regular accounting practices.

(2) "Equipment" means an article of nonexpendable, tangible personal property having a useful life of more than one year and an acquisition cost which equals the lesser of (a) the capitalization level established by the governmental unit for financial statement purposes, or (b) \$5000.

(3) "Other capital assets" mean buildings, land, and improvements to buildings or land that materially increase their value or useful life.

b. Capital expenditures which are not charged directly to a Federal award may be recovered through use allowances or depreciation on buildings, capital improvements, and equipment (see section 15). See also section 38 for allowability of rental costs for buildings and equipment.

c. Capital expenditures for equipment, including replacement equipment, other capital assets, and improvements which materially increase the value or useful life of equipment or other capital assets are allowable as a direct cost when approved by the awarding agency. Federal awarding agencies are authorized at their option to waive or delegate this approval requirement.

d. Items of equipment with an acquisition cost of less than \$5000 are considered to be supplies and are allowable as direct costs of Federal awards without specific awarding agency approval.

e. The unamortized portion of any equipment written off as a result of a change in capitalization levels may be recovered by (1) continuing to claim the otherwise allowable use allowances or depreciation charges on the equipment or by (2) amortizing the amount to be written off over a period of years negotiated with the cognizant agency.

f. When replacing equipment purchased in whole or in part with Federal funds, the governmental unit may use the equipment to be replaced as a trade-in or sell the property and use the proceeds to offset the cost of the replacement property.

20. Fines and penalties. Fines, penalties, damages, and other settlements resulting from violations (or alleged violations) of, or failure of the governmental unit to comply with, Federal, State, local, or Indian tribal laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the Federal award or written instructions by the awarding agency authorizing in advance such payments.

21. Fund raising and investment management costs.

a. Costs of organized fund raising, including financial campaigns, solicitation of gifts and bequests, and similar expenses incurred to raise capital or obtain contributions are unallowable, regardless of the purpose for which the funds will be used.

b. Costs of investment counsel and staff and similar expenses incurred to enhance income from investments are unallowable. However, such costs associated with investments covering pension, self-insurance, or other funds which include Federal participation allowed by this Circular are allowable.

c. Fund raising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in subsection C.3.b. of Attachment A.

22. Gains and losses on disposition of depreciable property and other capital assets and substantial relocation of Federal programs.

a. (1) Gains and losses on the sale, retirement, or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to the asset cost grouping(s) in which the property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate asset cost grouping(s) shall be the difference between the amount realized on the property and the undepreciated basis of the property.

(2) Gains and losses on the disposition of depreciable property shall not be recognized as a separate credit or charge under the following conditions:

(a) The gain or loss is processed through a depreciation account and is reflected in the depreciation allowable under sections 15 and 19.

(b) The property is given in exchange as part of the purchase price of a similar item and the gain or loss is taken into account in determining the depreciation cost basis of the new item.

(c) A loss results from the failure to maintain permissible insurance, except as otherwise provided in subsection 25.d.

(d) Compensation for the use of the property was provided through use allowances in lieu of depreciation.

b. Substantial relocation of Federal awards from a facility where the Federal Government participated in the financing to another facility prior to the expiration of the useful life of the financed facility requires Federal agency approval. The extent of the relocation, the amount of the Federal participation in the financing, and the depreciation charged to date may require negotiation of space charges for Federal awards.

c. Gains or losses of any nature arising from the sale or exchange of property other than the property covered in subsection a., e.g., land or included in the fair market value used in any adjustment resulting from a relocation of Federal awards covered in subsection b. shall be excluded in computing Federal award costs.

23. General government expenses.

a. The general costs of government are unallowable (except as provided in section 41). These include:

(1) Salaries and expenses of the Office of the Governor of a State or the chief executive of a political subdivision or the chief executives of federally-recognized Indian tribal governments;

(2) Salaries and other expenses of State legislatures, tribal councils, or similar local governmental bodies, such as county supervisors, city councils, school boards, etc., whether incurred for purposes of legislation or executive direction;

(3) Cost of the judiciary branch of a government;

(4) Cost of prosecutorial activities unless treated as a direct cost to a specific program when authorized by program regulations (however, this does not preclude the allowability of other legal activities of the Attorney General); and

(5) Other general types of government services normally provided to the general public, such as fire and police, unless provided for as a direct cost in program regulations.

b. For federally-recognized Indian tribal governments and Councils Of Governments (COGs), the portion of salaries and expenses directly attributable to managing and operating Federal programs by the chief executive and his staff is allowable.

24. Idle facilities and idle capacity.

a. As used in this section the following terms have the meanings set forth below:

(1) "Facilities" means land and buildings or any portion thereof, equipment individually or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the governmental unit.

(2) "Idle facilities" means completely unused facilities that are excess to the governmental unit's current needs.

(3) "Idle capacity" means the unused capacity of partially used facilities. It is the difference between (a) that which a facility could achieve under 100 percent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays and (b) the extent to which the facility was actually used to meet demands during the accounting period. A multi-shift basis should be used if it can be shown that this amount of usage would normally be expected for the type of facility involved.

(4) "Cost of idle facilities or idle capacity" means costs such as maintenance, repair, housing, rent, and other related costs, e.g., insurance, interest, and depreciation or use allowances.

b. The costs of idle facilities are unallowable except to the extent that:

(1) They are necessary to meet fluctuations in workload; or

(2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen. Under the exception stated in this subsection, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending on the initiative taken to use, lease, or dispose of such facilities.

c. The costs of idle capacity are normal costs of doing business and are a factor in the normal fluctuations of usage or indirect cost rates from period to period. Such costs are allowable, provided that the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by use on other Federal awards, subletting, renting, or sale, in accordance with sound business, economic, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be considered idle facilities.

25. Insurance and indemnification.

a. Costs of insurance required or approved and maintained, pursuant to the Federal award, are allowable.

b. Costs of other insurance in connection with the general conduct of activities are allowable subject to the following limitations:

(1) Types and extent and cost of coverage are in accordance with the governmental unit's policy and sound business practice.

(2) Costs of insurance or of contributions to any reserve covering the risk of loss of, or damage to, Federal Government property are unallowable except to the extent that the awarding agency has specifically required or approved such costs.

c. Actual losses which could have been covered by permissible insurance (through a self-insurance program or otherwise) are unallowable, unless expressly provided for in the Federal award or as described below. However, the Federal Government will participate in actual losses of a self insurance fund that are in excess of reserves. Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound management practice, and minor losses not covered by insurance, such as spoilage, breakage, and disappearance of small hand tools, which occur in the ordinary course of operations, are allowable.

d. Contributions to a reserve for certain self-insurance programs including workers compensation, unemployment compensation, and severance pay are allowable subject to the following provisions:

(1) The type of coverage and the extent of coverage and the rates and premiums would have been allowed had insurance (including reinsurance) been purchased to cover the risks. However, provision for known or reasonably estimated self-insured liabilities, which do not become payable for more than one year after the provision is made, shall not exceed the discounted present value of the liability. The rate used for discounting the liability must be determined by giving consideration to such factors as the governmental unit's settlement rate for those liabilities and its investment rate of return.

(2) Earnings or investment income on reserves must be credited to those reserves.

(3) Contributions to reserves must be based on sound actuarial principles using historical experience and reasonable assumptions. Reserve levels must be analyzed and updated at least biennially for each major risk being insured and take into account any reinsurance, coinsurance, etc. Reserve levels related to employee-related coverages will normally be limited to the value of claims (a) submitted and adjudicated but not paid, (b) submitted but not adjudicated, and (c) incurred but not submitted. Reserve levels in excess of the amounts based on the above must be

identified and justified in the cost allocation plan or indirect cost rate proposal.

(4) Accounting records, actuarial studies, and cost allocations (or billings) must recognize any significant differences due to types of insured risk and losses generated by the various insured activities or agencies of the governmental unit. If individual departments or agencies of the governmental unit experience significantly different levels of claims for a particular risk, those differences are to be recognized by the use of separate allocations or other techniques resulting in an equitable allocation.

(5) Whenever funds are transferred from a self-insurance reserve to other accounts (e.g., general fund), refunds shall be made to the Federal Government for its share of funds transferred, including earned or imputed interest from the date of transfer.

e. Actual claims paid to or on behalf of employees or former employees for workers' compensation, unemployment compensation, severance pay, and similar employee benefits (e.g., subsection 11.f. for post retirement health benefits), are allowable in the year of payment provided (1) the governmental unit follows a consistent costing policy and (2) they are allocated as a general administrative expense to all activities of the governmental unit.

f. Insurance refunds shall be credited against insurance costs in the year the refund is received.

g. Indemnification includes securing the governmental unit against liabilities to third persons and other losses not compensated by insurance or otherwise. The Federal Government is obligated to indemnify the governmental unit only to the extent expressly provided for in the Federal award, except as provided in subsection d.

h. Costs of commercial insurance that protects against the costs of the contractor for correction of the contractor's own defects in materials or workmanship are unallowable.

26. Interest.

a. Costs incurred for interest on borrowed capital or the use of a governmental unit's own funds, however represented, are unallowable except as specifically provided in subsection b. or authorized by Federal legislation.

b. Financing costs (including interest) paid or incurred on or after the effective date of this Circular associated with the otherwise allowable costs of building acquisition, construction, or fabrication, reconstruction or remodeling completed on or after October 1, 1980 is allowable, subject to the conditions in (1)-(4). Financing costs (including interest) paid or incurred on or after the effective date of this Circular associated with otherwise allowable costs of equipment is allowable, subject to the conditions in (1)-(4).

(1) The financing is provided (from other than tax or user fee sources) by a bona fide third party external to the governmental unit;

(2) The assets are used in support of Federal awards;

(3) Earnings on debt service reserve funds or interest earned on borrowed funds pending payment of the construction or acquisition costs are used to offset the current period's cost or the capitalized interest, as appropriate. Earnings subject to being reported to the Federal Internal Revenue Service under arbitrage requirements are excludable.

(4) Governmental units will negotiate the amount of allowable interest whenever cash payments (interest, depreciation, use allowances, and contributions) exceed the governmental unit's cash payments and other contributions attributable to that portion of real property used for Federal awards.

27. Lobbying. The cost of certain influencing activities associated with obtaining grants, contracts, cooperative agreements, or loans is an unallowable cost. Lobbying with respect to certain grants, contracts, cooperative agreements, and loans shall be governed by the common rule, "New Restrictions on Lobbying" published at 55 FR 6736 (February 26, 1990), including definitions, and the Office of Management and Budget "Government-wide Guidance for New Restrictions on Lobbying" and notices published at 54 FR 52306 (December 20, 1989), 55 FR 24540 (June 15, 1990), and 57 FR 1772 (January 15, 1992), respectively.

28. Maintenance, operations, and repairs. Unless prohibited by law, the cost of utilities, insurance, security, janitorial services, elevator service, upkeep of grounds, necessary maintenance, normal repairs and alterations, and the like are allowable to the extent that they: (1) keep property (including Federal property, unless otherwise provided for) in an efficient operating condition, (2) do not add to the permanent value of property or appreciably prolong its intended life, and (3) are not otherwise included in rental or other charges for space. Costs which add to the permanent value of property or appreciably prolong its intended life shall be treated as capital expenditures (see sections 15 and 19).

29. Materials and supplies. The cost of materials and supplies is allowable. Purchases should be charged at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received. Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing, consistently applied. Incoming transportation charges are a proper part of materials and supply costs.

30. Memberships, subscriptions, and professional activities.

- a. Costs of the governmental unit's memberships in business, technical, and professional organizations are allowable.
- b. Costs of the governmental unit's subscriptions to business, professional, and technical periodicals are allowable.
- c. Costs of meetings and conferences where the primary purpose is the dissemination of technical information, including meals, transportation, rental of meeting facilities, and other incidental costs are allowable.
- d. Costs of membership in civic and community, social organizations are allowable as a direct cost with the approval of the Federal awarding agency.
- e. Costs of membership in organizations substantially engaged in lobbying are unallowable.

31. Motor pools. The costs of a service organization which provides automobiles to user governmental units at a mileage or fixed rate and/or provides vehicle maintenance, inspection, and repair services are allowable.

32. Pre-award costs. Pre-award costs are those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs are necessary to comply with the proposed delivery schedule or period of performance. Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

33. Professional service costs.

- a. Cost of professional and consultant services rendered by persons or organizations that are members of a particular profession or possess a special skill, whether or not officers or employees of the governmental unit, are allowable, subject to section 14 when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Federal Government.
- b. Retainer fees supported by evidence of bona fide services available or rendered are allowable.

34. Proposal costs. Costs of preparing proposals for potential Federal awards are allowable. Proposal costs should normally be treated as indirect costs and should be allocated to all activities of the governmental unit utilizing the cost allocation plan and indirect cost rate proposal. However, proposal costs may be charged directly to Federal awards with the prior approval of the Federal awarding agency.

35. Publication and printing costs. Publication costs, including the costs of printing (including the processes of composition, plate-making, press work, and binding, and the end products produced by such processes), distribution, promotion, mailing, and general handling are allowable.

36. Rearrangements and alterations. Costs incurred for ordinary and normal rearrangement and alteration of facilities are allowable. Special arrangements and alterations costs incurred specifically for a Federal award are allowable with the prior approval of the Federal awarding agency.

37. Reconversion costs. Costs incurred in the restoration or rehabilitation of the governmental unit's facilities to approximately the same condition existing immediately prior to commencement of Federal awards, less costs related to normal wear and tear, are allowable.

38. Rental costs.

- a. Subject to the limitations described in subsections b. through d. of this section, rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternatives available; and, the type, life expectancy, condition, and value of the property leased.
- b. Rental costs under sale and leaseback arrangements are allowable only up to the amount that would be allowed had the governmental unit continued to own the property.
- c. Rental costs under less-than-arms-length leases are allowable only up to the amount that would be allowed had title to the property vested in the governmental unit. For this purpose, less-than-arms-length leases include, but are

not limited to, those where:

- (1) One party to the lease is able to control or substantially influence the actions of the other;
- (2) Both parties are parts of the same governmental unit; or
- (3) The governmental unit creates an authority or similar entity to acquire and lease the facilities to the governmental unit and other parties.

d. Rental costs under leases which are required to be treated as capital leases under GAAP are allowable only up to the amount that would be allowed had the governmental unit purchased the property on the date the lease agreement was executed. This amount would include expenses such as depreciation or use allowance, maintenance, and insurance. The provisions of Financial Accounting Standards Board Statement 13 shall be used to determine whether a lease is a capital lease. Interest costs related to capital leases are allowable to the extent they meet the criteria in section 26.

39. Taxes.

a. Taxes that a governmental unit is legally required to pay are allowable, except for self-assessed taxes that disproportionately affect Federal programs or changes in tax policies that disproportionately affect Federal programs. This provision becomes effective for taxes paid during the governmental unit's first fiscal year that begins on or after January 1, 1998, and applies thereafter.

b. Gasoline taxes, motor vehicle fees, and other taxes that are in effect user fees for benefits provided to the Federal Government are allowable.

c. This provision does not restrict the authority of Federal agencies to identify taxes where Federal participation is inappropriate. Where the identification of the amount of unallowable taxes would require an inordinate amount of effort, the cognizant agency may accept a reasonable approximation thereof.

40. Training. The cost of training provided for employee development is allowable.

41. Travel costs.

a. General. Travel costs are allowable for expenses for transportation, lodging, subsistence, and related items incurred by employees traveling on official business. Such costs may be charged on an actual cost basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip, and results in charges consistent with those normally allowed in like circumstances in non-federally-sponsored activities. Notwithstanding the provisions of section 23, travel costs of officials covered by that section, when specifically related to Federal awards, are allowable with the prior approval of a grantor agency.

b. Lodging and subsistence. Costs incurred by employees and officers for travel, including costs of lodging, other subsistence, and incidental expenses, shall be considered reasonable and allowable only to the extent such costs do not exceed charges normally allowed by the governmental unit in its regular operations as a result of the governmental unit's policy. In the absence of a written governmental unit policy regarding travel costs, the rates and amounts established under subchapter I of Chapter 57 of Title 5, United States Code "Travel and Subsistence Expenses; Mileage Allowances," or by the Administrator of General Services, or the President (or his designee) pursuant to any provisions of such subchapter shall be used as guidance for travel under Federal awards (41 U.S.C. 420, "Travel Expenses of Government Contractors").

c. Commercial air travel. Airfare costs in excess of the customary standard (coach or equivalent) airfare, are unallowable except when such accommodations would: require circuitous routing, require travel during unreasonable hours, excessively prolong travel, greatly increase the duration of the flight, result in increased cost that would offset transportation savings, or offer accommodations not reasonably adequate for the medical needs of the traveler. Where a governmental unit can reasonably demonstrate to the awarding agency either the nonavailability of customary standard airfare or Federal Government contract airfare for individual trips or, on an overall basis, that it is the governmental unit's practice to make routine use of such airfare, specific determinations of nonavailability will generally not be questioned by the Federal Government, unless a pattern of avoidance is detected. However, in order for airfare costs in excess of the customary standard commercial airfare to be allowable, e.g., use of first-class airfare, the governmental unit must justify and document on a case-by-case basis the applicable condition(s) set forth above.

d. Air travel by other than commercial carrier. Cost of travel by governmental unit-owned, -leased, or -chartered aircraft, as used in this section, includes the cost of lease, charter, operation (including personnel costs), maintenance, depreciation, interest, insurance, and other related costs. Costs of travel via governmental unit-owned,

-leased, or -chartered aircraft are unallowable to the extent they exceed the cost of allowable commercial air travel, as provided for in subsection c.

42. Underrecovery of costs under Federal agreements. Any excess costs over the Federal contribution under one award agreement are unallowable under other award agreements.

STATE/LOCAL-WIDE CENTRAL SERVICE COST ALLOCATION PLANS

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A. General.

1. Most governmental units provide certain services, such as motor pools, computer centers, purchasing, accounting, etc., to operating agencies on a centralized basis. Since federally-supported awards are performed within the individual operating agencies, there needs to be a process whereby these central service costs can be identified and assigned to benefitted activities on a reasonable and consistent basis. The central service cost allocation plan provides that process. All costs and other data used to distribute the costs included in the plan should be supported by formal accounting and other records that will support the propriety of the costs assigned to Federal awards.

2. Guidelines and illustrations of central service cost allocation plans are provided in a brochure published by the Department of Health and Human Services entitled "A Guide for State and Local Government Agencies: Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Grants and Contracts with the Federal Government." A copy of this brochure may be obtained from the Superintendent of Documents, U.S. Government Printing Office.

B. Definitions.

1. "Billed central services" means central services that are billed to benefitted agencies and/or programs on an individual fee-for-service or similar basis. Typical examples of billed central services include computer services, transportation services, insurance, and fringe benefits.

2. "Allocated central services" means central services that benefit operating agencies but are not billed to the agencies on a fee-for-service or similar basis. These costs are allocated to benefitted agencies on some reasonable

basis. Examples of such services might include general accounting, personnel administration, purchasing, etc.

3. "Agency or operating agency" means an organizational unit or sub-division within a governmental unit that is responsible for the performance or administration of awards or activities of the governmental unit.

C. Scope of the Central Service Cost Allocation Plans. The central service cost allocation plan will include all central service costs that will be claimed (either as a billed or an allocated cost) under Federal awards and will be documented as described in section E. Costs of central services omitted from the plan will not be reimbursed.

D. Submission Requirements.

1. Each State will submit a plan to the Department of Health and Human Services for each year in which it claims central service costs under Federal awards. The plan should include (a) a projection of the next year's allocated central service cost (based either on actual costs for the most recently completed year or the budget projection for the coming year), and (b) a reconciliation of actual allocated central service costs to the estimated costs used for either the most recently completed year or the year immediately preceding the most recently completed year.

2. Each local government that has been designated as a "major local government" by the Office of Management and Budget (OMB) is also required to submit a plan to its cognizant agency annually. OMB periodically lists major local governments in the Federal Register.

3. All other local governments claiming central service costs must develop a plan in accordance with the requirements described in this Circular and maintain the plan and related supporting documentation for audit. These local governments are not required to submit their plans for Federal approval unless they are specifically requested to do so by the cognizant agency. Where a local government only receives funds as a sub-recipient, the primary recipient will be responsible for negotiating indirect cost rates and/or monitoring the sub-recipient's plan.

4. All central service cost allocation plans will be prepared and, when required, submitted within six months prior to the beginning of each of the governmental unit's fiscal years in which it proposes to claim central service costs. Extensions may be granted by the cognizant agency on a case-by-case basis.

E. Documentation Requirements for Submitted Plans. The documentation requirements described in this section may be modified, expanded, or reduced by the cognizant agency on a case-by-case basis. For example, the requirements may be reduced for those central services which have little or no impact on Federal awards. Conversely, if a review of a plan indicates that certain additional information is needed, and will likely be needed in future years, it may be routinely requested in future plan submissions. Items marked with an asterisk (*) should be submitted only once; subsequent plans should merely indicate any changes since the last plan.

1. General. All proposed plans must be accompanied by the following: an organization chart sufficiently detailed to show operations including the central service activities of the State/local government whether or not they are shown as benefiting from central service functions; a copy of the Comprehensive Annual Financial Report (or a copy of the Executive Budget if budgeted costs are being proposed) to support the allowable costs of each central service activity included in the plan; and, a certification (see subsection 4.) that the plan was prepared in accordance with this Circular, contains only allowable costs, and was prepared in a manner that treated similar costs consistently among the various Federal awards and between Federal and non-Federal awards/activities.

2. Allocated central services. For each allocated central service, the plan must also include the following: a brief description of the service*, an identification of the unit rendering the service and the operating agencies receiving the service, the items of expense included in the cost of the service, the method used to distribute the cost of the service to benefitted agencies, and a summary schedule showing the allocation of each service to the specific benefitted agencies. If any self-insurance funds or fringe benefits costs are treated as allocated (rather than billed) central services, documentation discussed in subsections 3.b. and c. shall also be included.

3. Billed services.

a. General. The information described below shall be provided for all billed central services, including internal service funds, self-insurance funds, and fringe benefit funds.

b. Internal service funds.

(1) For each internal service fund or similar activity with an operating budget of \$5 million or more, the plan shall include: a brief description of each service; a balance sheet for each fund based on individual accounts contained in the governmental unit's accounting system; a revenue/expenses statement, with revenues broken out by source, e.g., regular billings, interest earned, etc.; a listing of all non-operating transfers (as defined by Generally Accepted Accounting Principles (GAAP)) into and out of the fund; a description of the procedures (methodology) used to charge

the costs of each service to users, including how billing rates are determined; a schedule of current rates; and, a schedule comparing total revenues (including imputed revenues) generated by the service to the allowable costs of the service, as determined under this Circular, with an explanation of how variances will be handled.

(2) Revenues shall consist of all revenues generated by the service, including unbilled and uncollected revenues. If some users were not billed for the services (or were not billed at the full rate for that class of users), a schedule showing the full imputed revenues associated with these users shall be provided. Expenses shall be broken out by object cost categories (e.g., salaries, supplies, etc.).

c. Self-insurance funds. For each self-insurance fund, the plan shall include: the fund balance sheet; a statement of revenue and expenses including a summary of billings and claims paid by agency; a listing of all non-operating transfers into and out of the fund; the type(s) of risk(s) covered by the fund (e.g., automobile liability, workers' compensation, etc.); an explanation of how the level of fund contributions are determined, including a copy of the current actuarial report (with the actuarial assumptions used) if the contributions are determined on an actuarial basis; and, a description of the procedures used to charge or allocate fund contributions to benefitted activities. Reserve levels in excess of claims (1) submitted and adjudicated but not paid, (2) submitted but not adjudicated, and (3) incurred but not submitted must be identified and explained.

d. Fringe benefits. For fringe benefit costs, the plan shall include: a listing of fringe benefits provided to covered employees, and the overall annual cost of each type of benefit; current fringe benefit policies*; and procedures used to charge or allocate the costs of the benefits to benefitted activities. In addition, for pension and post-retirement health insurance plans, the following information shall be provided: the governmental unit's funding policies, e.g., legislative bills, trust agreements, or State-mandated contribution rules, if different from actuarially determined rates; the pension plan's costs accrued for the year; the amount funded, and date(s) of funding; a copy of the current actuarial report (including the actuarial assumptions); the plan trustee's report; and, a schedule from the activity showing the value of the interest cost associated with late funding.

4. Required certification. Each central service cost allocation plan will be accompanied by a certification in the following form:

CERTIFICATE OF COST ALLOCATION PLAN

This is to certify that I have reviewed the cost allocation plan submitted herewith and to the best of my knowledge and belief:

(1) All costs included in this proposal [identify date] to establish cost allocations or billings for [identify period covered by plan] are allowable in accordance with the requirements of OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments," and the Federal award(s) to which they apply. Unallowable costs have been adjusted for in allocating costs as indicated in the cost allocation plan.

(2) All costs included in this proposal are properly allocable to Federal awards on the basis of a beneficial or causal relationship between the expenses incurred and the awards to which they are allocated in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs. Similar types of costs have been accounted for consistently.

I declare that the foregoing is true and correct.

Governmental Unit: _____

Signature: _____

Name of Official: _____

Title: _____

Date of Execution: _____

F. Negotiation and Approval of Central Service Plans.

1. All proposed central service cost allocation plans that are required to be submitted will be reviewed, negotiated, and approved by the Federal cognizant agency on a timely basis. The cognizant agency will review the proposal within six months of receipt of the proposal and either negotiate/approve the proposal or advise the governmental unit of the additional documentation needed to support/evaluate the proposed plan or the changes required to make the proposal acceptable. Once an agreement with the governmental unit has been reached, the agreement will be accepted and used by all Federal agencies, unless prohibited or limited by statute. Where a Federal funding agency

has reason to believe that special operating factors affecting its awards necessitate special consideration, the funding agency will, prior to the time the plans are negotiated, notify the cognizant agency.

2. The results of each negotiation shall be formalized in a written agreement between the cognizant agency and the governmental unit. This agreement will be subject to re-opening if the agreement is subsequently found to violate a statute or the information upon which the plan was negotiated is later found to be materially incomplete or inaccurate. The results of the negotiation shall be made available to all Federal agencies for their use.

3. Negotiated cost allocation plans based on a proposal later found to have included costs that: (a) are unallowable (i) as specified by law or regulation, (ii) as identified in Attachment B of this Circular, or (iii) by the terms and conditions of Federal awards, or (b) are unallowable because they are clearly not allocable to Federal awards, shall be adjusted, or a refund shall be made at the option of the Federal cognizant agency. These adjustments or refunds are designed to correct the plans and do not constitute a reopening of the negotiation.

G. Other Policies.

1. Billed central service activities. Each billed central service activity must separately account for all revenues (including imputed revenues) generated by the service, expenses incurred to furnish the service, and profit/loss.

2. Working capital reserves. Internal service funds are dependent upon a reasonable level of working capital reserve to operate from one billing cycle to the next. Charges by an internal service activity to provide for the establishment and maintenance of a reasonable level of working capital reserve, in addition to the full recovery of costs, are allowable. A working capital reserve as part of retained earnings of up to 60 days cash expenses for normal operating purposes is considered reasonable. A working capital reserve exceeding 60 days may be approved by the cognizant Federal agency in exceptional cases.

3. Carry-forward adjustments of allocated central service costs. Allocated central service costs are usually negotiated and approved for a future fiscal year on a "fixed with carry-forward" basis. Under this procedure, the fixed amounts for the future year covered by agreement are not subject to adjustment for that year. However, when the actual costs of the year involved become known, the differences between the fixed amounts previously approved and the actual costs will be carried forward and used as an adjustment to the fixed amounts established for a later year. This "carry-forward" procedure applies to all central services whose costs were fixed in the approved plan. However, a carry-forward adjustment is not permitted, for a central service activity that was not included in the approved plan, or for unallowable costs that must be reimbursed immediately.

4. Adjustments of billed central services. Billing rates used to charge Federal awards shall be based on the estimated costs of providing the services, including an estimate of the allocable central service costs. A comparison of the revenue generated by each billed service (including total revenues whether or not billed or collected) to the actual allowable costs of the service will be made at least annually, and an adjustment will be made for the difference between the revenue and the allowable costs. These adjustments will be made through one of the following adjustment methods: (a) a cash refund to the Federal Government for the Federal share of the adjustment, (b) credits to the amounts charged to the individual programs, (c) adjustments to future billing rates, or (d) adjustments to allocated central service costs. Adjustments to allocated central services will not be permitted where the total amount of the adjustment for a particular service (Federal share and non-Federal) share exceeds \$500,000.

5. Records retention. All central service cost allocation plans and related documentation used as a basis for claiming costs under Federal awards must be retained for audit in accordance with the records retention requirements contained in the Common Rule.

6. Appeals. If a dispute arises in the negotiation of a plan between the cognizant agency and the governmental unit, the dispute shall be resolved in accordance with the appeals procedures of the cognizant agency.

7. OMB assistance. To the extent that problems are encountered among the Federal agencies and/or governmental units in connection with the negotiation and approval process, OMB will lend assistance, as required, to resolve such problems in a timely manner.

PUBLIC ASSISTANCE COST ALLOCATION PLANS

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F. Unallowable Costs

A. General. Federally-financed programs administered by State public assistance agencies are funded predominately by the Department of Health and Human Services (HHS). In support of its stewardship requirements, HHS has published requirements for the development, documentation, submission, negotiation, and approval of public assistance cost allocation plans in Subpart E of 45 CFR Part 95. All administrative costs (direct and indirect) are normally charged to Federal awards by implementing the public assistance cost allocation plan. This Attachment extends these requirements to all Federal agencies whose programs are administered by a State public assistance agency. Major federally-financed programs typically administered by State public assistance agencies include: Aid to Families with Dependent Children, Medicaid, Food Stamps, Child Support Enforcement, Adoption Assistance and Foster Care, and Social Services Block Grant.

B. Definitions.

1. "State public assistance agency" means a State agency administering or supervising the administration of one or more public assistance programs operated by the State as identified in Subpart E of 45 CFR Part 95. For the purpose of this Attachment, these programs include all programs administered by the State public assistance agency.

2. "State public assistance agency costs" means all costs incurred by, or allocable to, the State public assistance agency, except expenditures for financial assistance, medical vendor payments, food stamps, and payments for services and goods provided directly to program recipients.

C. Policy. State public assistance agencies will develop, document and implement, and the Federal Government will review, negotiate, and approve, public assistance cost allocation plans in accordance with Subpart E of 45 CFR Part 95. The plan will include all programs administered by the State public assistance agency. Where a letter of approval or disapproval is transmitted to a State public assistance agency in accordance with Subpart E, the letter will apply to all Federal agencies and programs. The remaining sections of this Attachment (except for the requirement for certification) summarize the provisions of Subpart E of 45 CFR Part 95.

D. Submission, Documentation, and Approval of Public Assistance Cost Allocation Plans.

1. State public assistance agencies are required to promptly submit amendments to the cost allocation plan to HHS for review and approval.

2. Under the coordination process outlined in subsection E, affected Federal agencies will review all new plans and plan amendments and provide comments, as appropriate, to HHS. The effective date of the plan or plan amendment will be the first day of the quarter following the submission of the plan or amendment, unless another date is specifically approved by HHS. HHS, as the cognizant agency acting on behalf of all affected Federal agencies, will, as necessary, conduct negotiations with the State public assistance agency and will inform the State agency of the action taken on the plan or plan amendment.

E. Review of Implementation of Approved Plans.

1. Since public assistance cost allocation plans are of a narrative nature, the review during the plan approval process consists of evaluating the appropriateness of the proposed groupings of costs (cost centers) and the related

allocation bases. As such, the Federal Government needs some assurance that the cost allocation plan has been implemented as approved. This is accomplished by reviews by the funding agencies, single audits, or audits conducted by the cognizant audit agency.

2. Where inappropriate charges affecting more than one funding agency are identified, the cognizant HHS cost negotiation office will be advised and will take the lead in resolving the issue(s) as provided for in Subpart E of 45 CFR Part 95.

3. If a dispute arises in the negotiation of a plan or from a disallowance involving two or more funding agencies, the dispute shall be resolved in accordance with the appeals procedures set out in 45 CFR Part 75. Disputes involving only one funding agency will be resolved in accordance with the funding agency's appeal process.

4. To the extent that problems are encountered among the Federal agencies and/or governmental units in connection with the negotiation and approval process, the Office of Management and Budget will lend assistance, as required, to resolve such problems in a timely manner.

F. Unallowable Costs. Claims developed under approved cost allocation plans will be based on allowable costs as identified in this Circular. Where unallowable costs have been claimed and reimbursed, they will be refunded to the program that reimbursed the unallowable cost using one of the following methods: (a) a cash refund, (b) offset to a subsequent claim, or (c) credits to the amounts charged to individual awards.

ATTACHMENT E
Circular No. A-87

STATE AND LOCAL INDIRECT COST RATE PROPOSALS

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A. General.

1. Indirect costs are those that have been incurred for common or joint purposes. These costs benefit more than one cost objective and cannot be readily identified with a particular final cost objective without effort disproportionate to the results achieved. After direct costs have been determined and assigned directly to Federal awards and other activities as appropriate, indirect costs are those remaining to be allocated to benefited cost objectives. A cost may not be allocated to a Federal award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to a Federal award as a direct cost.
2. Indirect costs include (a) the indirect costs originating in each department or agency of the governmental unit carrying out Federal awards and (b) the costs of central governmental services distributed through the central service cost allocation plan (as described in Attachment C) and not otherwise treated as direct costs.
3. Indirect costs are normally charged to Federal awards by the use of an indirect cost rate. A separate indirect cost rate(s) is usually necessary for each department or agency of the governmental unit claiming indirect costs under Federal awards. Guidelines and illustrations of indirect cost proposals are provided in a brochure published by the Department of Health and Human Services entitled "A Guide for State and Local Government Agencies: Cost Principles and Procedures for Establishing Cost Allocation Plans and Indirect Cost Rates for Grants and Contracts with the Federal Government." A copy of this brochure may be obtained from the Superintendent of Documents, U.S. Government Printing Office.
4. Because of the diverse characteristics and accounting practices of governmental units, the types of costs which may be classified as indirect costs cannot be specified in all situations. However, typical examples of indirect costs may include certain State/local-wide central service costs, general administration of the grantee department or agency, accounting and personnel services performed within the grantee department or agency, depreciation or use allowances on buildings and equipment, the costs of operating and maintaining facilities, etc.
5. This Attachment does not apply to State public assistance agencies. These agencies should refer instead to Attachment D.

B. Definitions.

1. "Indirect cost rate proposal" means the documentation prepared by a governmental unit or subdivision thereof to substantiate its request for the establishment of an indirect cost rate.
2. "Indirect cost rate" is a device for determining in a reasonable manner the proportion of indirect costs each program should bear. It is the ratio (expressed as a percentage) of the indirect costs to a direct cost base.
3. "Indirect cost pool" is the accumulated costs that jointly benefit two or more programs or other cost objectives.
4. "Base" means the accumulated direct costs (normally either total direct salaries and wages or total direct costs exclusive of any extraordinary or distorting expenditures) used to distribute indirect costs to individual Federal awards. The direct cost base selected should result in each award bearing a fair share of the indirect costs in reasonable relation to the benefits received from the costs.
5. "Predetermined rate" means an indirect cost rate, applicable to a specified current or future period, usually the governmental unit's fiscal year. This rate is based on an estimate of the costs to be incurred during the period. Except under very unusual circumstances, a predetermined rate is not subject to adjustment. (Because of legal constraints, predetermined rates are not permitted for Federal contracts; they may, however, be used for grants or cooperative agreements.) Predetermined rates may not be used by governmental units that have not submitted and negotiated the rate with the cognizant agency. In view of the potential advantages offered by this procedure, negotiation of predetermined rates for indirect costs for a period of two to four years should be the norm in those situations where the cost experience and other pertinent facts available are deemed sufficient to enable the parties involved to reach an informed judgment as to the probable level of indirect costs during the ensuing accounting periods.
6. "Fixed rate" means an indirect cost rate which has the same characteristics as a predetermined rate, except that the difference between the estimated costs and the actual, allowable costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period.
7. "Provisional rate" means a temporary indirect cost rate applicable to a specified period which is used for funding, interim reimbursement, and reporting indirect costs on Federal awards pending the establishment of a "final" rate for that period.

8. "Final rate" means an indirect cost rate applicable to a specified past period which is based on the actual allowable costs of the period. A final audited rate is not subject to adjustment.

9. "Base period" for the allocation of indirect costs is the period in which such costs are incurred and accumulated for allocation to activities performed in that period. The base period normally should coincide with the governmental unit's fiscal year, but in any event, shall be so selected as to avoid inequities in the allocation of costs.

C. Allocation of Indirect Costs and Determination of Indirect Cost Rates.

1. General.

a. Where a governmental unit's department or agency has only one major function, or where all its major functions benefit from the indirect costs to approximately the same degree, the allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures as described in subsection 2.

b. Where a governmental unit's department or agency has several major functions which benefit from its indirect costs in varying degrees, the allocation of indirect costs may require the accumulation of such costs into separate cost groupings which then are allocated individually to benefited functions by means of a base which best measures the relative degree of benefit. The indirect costs allocated to each function are then distributed to individual awards and other activities included in that function by means of an indirect cost rate(s).

c. Specific methods for allocating indirect costs and computing indirect cost rates along with the conditions under which each method should be used are described in subsections 2, 3 and 4.

2. Simplified method.

a. Where a grantee agency's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (1) classifying the grantee agency's total costs for the base period as either direct or indirect, and (2) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate which is used to distribute indirect costs to individual Federal awards. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used where a governmental unit's department or agency has only one major function encompassing a number of individual projects or activities, and may be used where the level of Federal awards to that department or agency is relatively small.

b. Both the direct costs and the indirect costs shall exclude capital expenditures and unallowable costs. However, unallowable costs must be included in the direct costs if they represent activities to which indirect costs are properly allocable.

c. The distribution base may be (1) total direct costs (excluding capital expenditures and other distorting items, such as pass-through funds, major subcontracts, etc.), (2) direct salaries and wages, or (3) another base which results in an equitable distribution.

3. Multiple allocation base method.

a. Where a grantee agency's indirect costs benefit its major functions in varying degrees, such costs shall be accumulated into separate cost groupings. Each grouping shall then be allocated individually to benefited functions by means of a base which best measures the relative benefits.

b. The cost groupings should be established so as to permit the allocation of each grouping on the basis of benefits provided to the major functions. Each grouping should constitute a pool of expenses that are of like character in terms of the functions they benefit and in terms of the allocation base which best measures the relative benefits provided to each function. The number of separate groupings should be held within practical limits, taking into consideration the materiality of the amounts involved and the degree of precision needed.

c. Actual conditions must be taken into account in selecting the base to be used in allocating the expenses in each grouping to benefited functions. When an allocation can be made by assignment of a cost grouping directly to the function benefited, the allocation shall be made in that manner. When the expenses in a grouping are more general in nature, the allocation should be made through the use of a selected base which produces results that are equitable to both the Federal Government and the governmental unit. In general, any cost element or related factor associated with the governmental unit's activities is potentially adaptable for use as an allocation base provided that: (1) it can readily be expressed in terms of dollars or other quantitative measures (total direct costs, direct salaries and wages, staff hours applied, square feet used, hours of usage, number of documents processed, population served, and the like), and (2) it is common to the benefited functions during the base period.

d. Except where a special indirect cost rate(s) is required in accordance with subsection 4, the separate groupings of indirect costs allocated to each major function shall be aggregated and treated as a common pool for that function. The costs in the common pool shall then be distributed to individual Federal awards included in that function by use of a single indirect cost rate.

e. The distribution base used in computing the indirect cost rate for each function may be (1) total direct costs (excluding capital expenditures and other distorting items such as pass-through funds, major subcontracts, etc.), (2) direct salaries and wages, or (3) another base which results in an equitable distribution. An indirect cost rate should be developed for each separate indirect cost pool developed. The rate in each case should be stated as the percentage relationship between the particular indirect cost pool and the distribution base identified with that pool.

4. Special indirect cost rates.

a. In some instances, a single indirect cost rate for all activities of a grantee department or agency or for each major function of the agency may not be appropriate. It may not take into account those different factors which may substantially affect the indirect costs applicable to a particular program or group of programs. The factors may include the physical location of the work, the level of administrative support required, the nature of the facilities or other resources employed, the organizational arrangements used, or any combination thereof. When a particular award is carried out in an environment which appears to generate a significantly different level of indirect costs, provisions should be made for a separate indirect cost pool applicable to that award. The separate indirect cost pool should be developed during the course of the regular allocation process, and the separate indirect cost rate resulting therefrom should be used, provided that: (1) the rate differs significantly from the rate which would have been developed under subsections 2. and 3., and (2) the award to which the rate would apply is material in amount.

b. Although this Circular adopts the concept of the full allocation of indirect costs, there are some Federal statutes which restrict the reimbursement of certain indirect costs. Where such restrictions exist, it may be necessary to develop a special rate for the affected award. Where a "restricted rate" is required, the procedure for developing a non-restricted rate will be used except for the additional step of the elimination from the indirect cost pool those costs for which the law prohibits reimbursement.

D. Submission and Documentation of Proposals.

1. Submission of indirect cost rate proposals.

a. All departments or agencies of the governmental unit desiring to claim indirect costs under Federal awards must prepare an indirect cost rate proposal and related documentation to support those costs. The proposal and related documentation must be retained for audit in accordance with the records retention requirements contained in the Common Rule.

b. A governmental unit for which a cognizant agency assignment has been specifically designated must submit its indirect cost rate proposal to its cognizant agency. The Office of Management and Budget (OMB) will periodically publish lists of governmental units identifying the appropriate Federal cognizant agencies. The cognizant agency for all governmental units or agencies not identified by OMB will be determined based on the Federal agency providing the largest amount of Federal funds. In these cases, a governmental unit must develop an indirect cost proposal in accordance with the requirements of this Circular and maintain the proposal and related supporting documentation for audit. These governmental units are not required to submit their proposals unless they are specifically requested to do so by the cognizant agency. Where a local government only receives funds as a sub-recipient, the primary recipient will be responsible for negotiating and/or monitoring the sub-recipient's plan.

c. Each Indian tribal government desiring reimbursement of indirect costs must submit its indirect cost proposal to the Department of the Interior (its cognizant Federal agency).

d. Indirect cost proposals must be developed (and, when required, submitted) within six months after the close of the governmental unit's fiscal year, unless an exception is approved by the cognizant Federal agency. If the proposed central service cost allocation plan for the same period has not been approved by that time, the indirect cost proposal may be prepared including an amount for central services that is based on the latest federally-approved central service cost allocation plan. The difference between these central service amounts and the amounts ultimately approved will be compensated for by an adjustment in a subsequent period.

2. Documentation of proposals. The following shall be included with each indirect cost proposal:

a. The rates proposed, including subsidiary work sheets and other relevant data, cross referenced and reconciled to the financial data noted in subsection b. Allocated central service costs will be supported by the summary table included in the approved central service cost allocation plan. This summary table is not required to be submitted with the indirect cost proposal if the central service cost allocation plan for the same fiscal year has been approved by the

cognizant agency and is available to the funding agency.

b. A copy of the financial data (financial statements, comprehensive annual financial report, executive budgets, accounting reports, etc.) upon which the rate is based. Adjustments resulting from the use of unaudited data will be recognized, where appropriate, by the Federal cognizant agency in a subsequent proposal.

c. The approximate amount of direct base costs incurred under Federal awards. These costs should be broken out between salaries and wages and other direct costs.

d. A chart showing the organizational structure of the agency during the period for which the proposal applies, along with a functional statement(s) noting the duties and/or responsibilities of all units that comprise the agency. (Once this is submitted, only revisions need be submitted with subsequent proposals.)

3. Required certification. Each indirect cost rate proposal shall be accompanied by a certification in the following form:

CERTIFICATE OF INDIRECT COSTS

This is to certify that I have reviewed the indirect cost rate proposal submitted herewith and to the best of my knowledge and belief:

(1) All costs included in this proposal [identify date] to establish billing or final indirect costs rates for [identify period covered by rate] are allowable in accordance with the requirements of the Federal award(s) to which they apply and OMB Circular A-87, "Cost Principles for State, Local, and Indian Tribal Governments." Unallowable costs have been adjusted for in allocating costs as indicated in the cost allocation plan.

(2) All costs included in this proposal are properly allocable to Federal awards on the basis of a beneficial or causal relationship between the expenses incurred and the agreements to which they are allocated in accordance with applicable requirements. Further, the same costs that have been treated as indirect costs have not been claimed as direct costs. Similar types of costs have been accounted for consistently and the Federal Government will be notified of any accounting changes that would affect the predetermined rate.

I declare that the foregoing is true and correct.

Governmental Unit: _____

Signature: _____

Name of Official: _____

Title: _____

Date of Execution: _____

E. Negotiation and Approval of Rates.

1. Indirect cost rates will be reviewed, negotiated, and approved by the cognizant Federal agency on a timely basis. Once a rate has been agreed upon, it will be accepted and used by all Federal agencies unless prohibited or limited by statute. Where a Federal funding agency has reason to believe that special operating factors affecting its awards necessitate special indirect cost rates, the funding agency will, prior to the time the rates are negotiated, notify the cognizant Federal agency.

2. The use of predetermined rates, if allowed, is encouraged where the cognizant agency has reasonable assurance based on past experience and reliable projection of the grantee agency's costs, that the rate is not likely to exceed a rate based on actual costs. Long-term agreements utilizing predetermined rates extending over two or more years are encouraged, where appropriate.

3. The results of each negotiation shall be formalized in a written agreement between the cognizant agency and the governmental unit. This agreement will be subject to re-opening if the agreement is subsequently found to violate a statute, or the information upon which the plan was negotiated is later found to be materially incomplete or inaccurate. The agreed upon rates shall be made available to all Federal agencies for their use.

4. Refunds shall be made if proposals are later found to have included costs that (a) are unallowable (i) as specified by law or regulation, (ii) as identified in Attachment B of this Circular, or (iii) by the terms and conditions of Federal awards, or (b) are unallowable because they are clearly not allocable to Federal awards. These adjustments or refunds will be made regardless of the type of rate negotiated (predetermined, final, fixed, or provisional).

F. Other Policies.

1. Fringe benefit rates. If overall fringe benefit rates are not approved for the governmental unit as part of the central service cost allocation plan, these rates will be reviewed, negotiated and approved for individual grantee agencies during the indirect cost negotiation process. In these cases, a proposed fringe benefit rate computation should accompany the indirect cost proposal. If fringe benefit rates are not used at the grantee agency level (i.e., the agency specifically identifies fringe benefit costs to individual employees), the governmental unit should so advise the cognizant agency.

2. Billed services provided by the grantee agency. In some cases, governmental units provide and bill for services similar to those covered by central service cost allocation plans (e.g., computer centers). Where this occurs, the governmental unit should be guided by the requirements in Attachment C relating to the development of billing rates and documentation requirements, and should advise the cognizant agency of any billed services. Reviews of these types of services (including reviews of costing/billing methodology, profits or losses, etc.) will be made on a case-by-case basis as warranted by the circumstances involved.

3. Indirect cost allocations not using rates. In certain situations, a governmental unit, because of the nature of its awards, may be required to develop a cost allocation plan that distributes indirect (and, in some cases, direct) costs to the specific funding sources. In these cases, a narrative cost allocation methodology should be developed, documented, maintained for audit, or submitted, as appropriate, to the cognizant agency for review, negotiation, and approval.

4. Appeals. If a dispute arises in a negotiation of an indirect cost rate (or other rate) between the cognizant agency and the governmental unit, the dispute shall be resolved in accordance with the appeals procedures of the cognizant agency.

5. Collection of unallowable costs and erroneous payments. Costs specifically identified as unallowable and charged to Federal awards either directly or indirectly will be refunded (including interest chargeable in accordance with applicable Federal agency regulations).

6. OMB assistance. To the extent that problems are encountered among the Federal agencies and/or governmental units in connection with the negotiation and approval process, OMB will lend assistance, as required, to resolve such problems in a timely manner.

ESEA (As Amended by the No Child Left Behind Act of 2001) - Excerpts Related to Supplement, Not Supplant

Applies to	Reference	May Not Supplant		Text of Provision
		Non Federal Funding Sources	Other Federal Funding Sources	
T. 1 Schoolwide Programs	1114(a)(2)(B)	X		SUPPLEMENTAL FUNDS - A school participating in a schoolwide program shall use funds available to carry out this section only to supplement the amount of funds that would, in the absence of funds under this part, be made available from non-Federal sources for the school, including funds needed to provide services that are required by law for children with disabilities and children with limited English proficiency.
T.1, Part A, T.1, Part C (Migrant), Part D (Neg and Del)	1120A(b)	X		FEDERAL FUNDS TO SUPPLEMENT, NOT SUPPLANT, NON-FEDERAL FUNDS (1) IN GENERAL - A State educational agency or local educational agency shall use Federal funds received under this part only to supplement the funds that would, in the absence of such Federal funds, be made available from non-Federal sources for the education of pupils participating in programs assisted under this part, and not to supplant such funds.
	1120A(c)			COMPARABILITY OF SERVICES - (1) IN GENERAL - (A) COMPARABLE SERVICES - State and local funds in schools served under this part <must be used> to provide services that, taken as a whole, are at least comparable to services in schools that are not receiving funds under this part. (B) SUBSTANTIALLY COMPARABLE SERVICES - If the LEAS is serving all of it schools under this part, such agency will use State and local funds to provide services that, taken as a whole, are substantially comparable in each school. (C) BASIS - A LEA may meet these requirements on a grade-span by grade-span basis or a school-by-school basis. <For purposes of determining compliance with this paragraph, a LEA may exclude State and local funds expended for language instruction educational programs; and the excess costs of providing services to children with disabilities as determined by the LEA>.
		Notes	Notes	(2) WRITTEN ASSURANCE - (A) EQUIVALENCE - A LEA shall be considered to have met the requirements of this paragraph if it has filed with the SEA a written assurance that the LEA has established and implemented (i) a local educational agency-wide salary schedule; (ii) a policy to ensure equivalence among schools in teachers, administrators, and other staff; and (iii) a policy to ensure equivalence among schools in the provision of curriculum materials and instructional supplies.

ESEA (As Amended by the No Child Left Behind Act of 2001) - Excerpts Related to Supplement, Not Supplant

Applies to	Reference	May Not Supplant		Text of Provision
		Non Federal Funding Sources	Other Federal Funding Sources	
T.1, Part A, T.1, Part C (Migrant)	1115(b)(3)			SPECIAL RULE - Funds received under this part may not be used to provide services that are otherwise required by law to be made available to children described in paragraph (2) Children who are economically disadvantaged, children with disabilities, migrant children or limited English proficient children, children in or 2 years previously in Head Start, Even Start, Early Reading First, Migrant, neg or del, or homeless but may be used to coordinate or supplement such services
		Notes	Notes	
T.1, Part A, Part D (Neg and Del)	1120A(d)			EXCLUSION OF FUNDS - For the purpose of complying with subsections (b) supplement vs. supplant and (c) comparability of services , a SEA or LEA may exclude supplemental State or local funds expended in any school attendance area or school for programs that meet the intent and purposes of this part.
		Notes	Notes	
T.1, Part B, Subpart 1 - (Reading First)	Added FY03 omnibus appropriation bill and amending the NCLB Act. Section 1202(g)	X		SUPPLEMENT, NOT SUPPLANT - A state or local educational agency shall use funds received under this subpart only to supplement the level of non-Federal funds that, in the absence of funds under this subpart, would be expended for activities authorized under this subpart, and not to supplant those non-Federal funds.
T.1, Part B, Subpart 4 - (Improving Literacy Through School Libraries)	1251(i)	X	X	SUPPLEMENT, NOT SUPPLANT - Funds made available under this section shall be used to supplement, and not supplant, other Federal, State, and local funds expended to carry out activities relating to library, technology, or professional development activities.
T.1, Part C (Migrant)	1306(a)(1)(B)(iii)	X		Each State that receives assistance under this part shall ensure that the State and its local operating agencies identify and address the special educational needs of migratory children in accordance with a comprehensive State plan that may be submitted as a part of a consolidated application under section 9302, if the comprehensive State plan is not used to supplant state efforts regarding, or administrative funding for, this part.
T.1, Part C (Migrant)	1306(b)(2)			UNADDRESSED NEEDS-Funds provided under this part shall be used to address the needs of migratory children that are not addressed by services available from other Federal or non-Federal programs, except that migratory children who are eligible to receive services under part A may receive those services through funds provided under that part, or through funds under this part that remain after the agency addresses the needs described in paragraph (1).
		Notes	Notes	

ESEA (As Amended by the No Child Left Behind Act of 2001) - Excerpts Related to Supplement, Not Supplant

Applies to	Reference	May Not Supplant		Text of Provision
		Non Federal Funding Sources	Other Federal Funding Sources	
T1. Part D, (Neg & Del)	1415(b)			SUPPLEMENT, NOT SUPPLANT - A program under this subpart that supplements the number of hours of instruction students receive from State and local sources shall be considered to comply with the supplement, not supplant requirement of section 1120A (as applied to this part) without regard to the subject areas in which instruction is given during those hours.
		Notes	Notes	
T.1, Part F, (Comprehensive School Reform)	1604(f)	X	X	SUPPLEMENT - Funds made available under this part shall be used to supplement, and not supplant, any other Federal, State, or local funds that would otherwise be available to carry out the activities assisted under this part.
T.1, Part G, (Advanced Placement)	1706	X		Grant funds provided under this part shall supplement, and not supplant, other non-Federal funds that are available to assist low-income individuals pay for the cost of advanced placement test fees or to expand access to advanced placement and preadvanced placement courses.
T.1, Part H, Subpart 2 (School Dropout Prevention Initiative)	1823(b)(1)(F)	X		<Each SEA and LEA application shall>provide an assurance that funds, provided under this subpart will supplement, and not supplant, other state and local funds available for school dropout prevention and reentry programs.
T.II, Part A, Subpart 1, Grants to States	2113(f)	X		SUPPLEMENT, NOT SUPPLANT - Funds received under this subpart shall be used to supplement, and not supplant, non-Federal funds that would otherwise be used for activities authorized under this subpart.
T.II, Part A, Subpart 2, (Subgrants to LEAs)	2123(b)	X		SUPPLEMENT, NOT SUPPLANT - Funds received under this subpart shall be used to supplement, and not supplant, non-Federal funds that would otherwise be used for activities authorized under this subpart.
T.II, Part B, (Grants for Math & Science Partnerships)	2202(a)(4)	X	X	SUPPLEMENT, NOT SUPPLANT - Funds received under this part shall be used to supplement, and not supplant, funds that would otherwise be used for activities authorized under this part.
T.II, Part C, Subpart 1, Chapter B (Transition to Teaching Program)	2313(h)(2)	X		“(2) SUPPLEMENT, NOT SUPPLANT.—Funds made available under this section shall be used to supplement, and not supplant, State and local public funds expended for teacher recruitment and retention programs, including programs to recruit the teachers through alternative routes to certification.
T.II, Part D, Subpart 1 (State and Local Technology Grants)	2413(b)(6)	X		<Each State application submitted under subsection (a) shall include>An assurance that financial assistance provided under this subpart will supplement, and not supplant, State and local funds
T. III, Part A, Subpart 1 (Grants and Subgrants for English Language Acquisition and Language Enhancement)	3115(g)	X	X	SUPPLEMENT, NOT SUPPLANT.—Federal funds made available under this subpa shall be used so as to supplement the level of Federal, State, and local public funds that, in the absence of such availability, would have been expended for programs for limited English proficient children and immigrant children and youth and in no case to supplant such Federal, State, and local public funds.

ESEA (As Amended by the No Child Left Behind Act of 2001) - Excerpts Related to Supplement, Not Supplant

Applies to	Reference	May Not Supplant		Text of Provision
		Non Federal Funding Sources	Other Federal Funding Sources	
T. III, Part B, Subpart 2 (Research, Evaluation, and Dissemination)	3224(f)	X		SUPPLEMENT, NOT SUPPLANT.—Federal funds made available under this section for any fiscal year shall be used by the State educational agency to supplement and, to the extent practical, to increase the State funds that, in the absence of such Federal funds, would be made available for the purposes described in this section, and in no case to supplant such State funds.
T.IV, Part A, (Safe and Drug-Free Schools and Communities)	4113(a)(8)	X		<A State shall submit to the Secretary...an application that...> Provides an assurance that funds under this subpart will be used to increase the level of State, local, and other non-Federal funds that would, in the absence of funds under 316 this subpart, be made available for programs and activities authorized under this subpart, and in no case supplant such State, local, and other non-Federal funds
T.IV, Part A, (Safe and Drug-Free Schools and Communities)	4114(d)(4)	X		<An application submitted by a local educational agency under this section shall contain...> an assurance that funds under this subpart will be used to increase the level of State, local, and other non-Federal funds that would, in the absence of funds under this subpart, be made available for programs and activities authorized under this subpart, and in no case supplant such State, local, and other non-Federal funds
T.IV, Part A, (Safe and Drug-Free Schools and Communities)	4115(c)(2)	Notes	Notes	EXCEPTION.—A local educational agency may use funds under this subpart for activities described in clauses (ii) through (v) of subsection (b)(2)(E) only if funding for these activities is not received from other Federal agencies
T.IV, Part A, Subpart 2 (National Programs-Hate Crimes)	4122(b)(3)(C)	X		<In order to be eligible to receive a grant under this section for any fiscal year, an LEA, or an LEA in conjunction with a Community Based Organization (CBO), shall submit an application to the Secretary...Each application...shall include assurances that Federal funds received under this section shall be used to supplement, and not supplant, non-Federal funds
T.IV, Part B, (21st Century Community Learning Centers) SEAs	4203(a)(9)	X	X	<A State shall submit to the Secretary...an application that...> contains an assurance that funds appropriated to carry out this part will be used to supplement, and not supplant, other Federal, State, and local public funds expended to provide programs and activities authorized under this part and other similar programs.
T.IV, Part B, (21st Century Community Learning Centers) LEAs	4204(b)(2)(G)	X	X	<...an eligible entity shall submit an application to the SEA...that shall include...an assurance that funds under this part will be used to increase the level of State, local, and other non-Federal funds that would, in the absence of funds under this part, be made available for programs and activities authorized under this part, and in no case supplant Federal, State, local, or non-Federal funds

ESEA (As Amended by the No Child Left Behind Act of 2001) - Excerpts Related to Supplement, Not Supplant

Applies to	Reference	May Not Supplant		Text of Provision
		Non Federal Funding Sources	Other Federal Funding Sources	
T.V, Part A (Innovative Programs), Subpart 4 , (General Provisions)	5144	X	X	'Funds made available under this part shall be used to supplement, and not supplant, any other Federal, State, or local education funds.
T.V, Part B (Public Charter Schools), Subpart 1, (Charter School Programs)	5205(b)(3)(C)	X		SUPPLEMENT, NOT SUPPLANT - Funds made available under this subsection shall be used to supplement, and not supplant, State and local public funds expended to provide per pupil facilities aid programs, operations financing programs, or other programs, for charter schools
T.V, Part D (FIE), Subpart 2 , (Elementary and Secondary School Counseling Programs)	5421(a)(6)	X	X	SUPPLEMENT, NOT SUPPLANT.—Funds made available under this section shall be used to supplement, and not supplant, other Federal, State, or local funds used for providing school-based counseling and mental health services to students
T.V, Part D (FIE), Subpart 7 , (Star Schools Program)	5473(c)(3)	Notes	Notes	SUPPLEMENT, NOT SUPPLANT.—Grant funds received under this subsection shall be used to supplement, and not supplant, services provided by the grant recipient under this subpart in the previous fiscal year.
T.V, Part D (FIE), Subpart 10, (Physical Education)	5507	X	X	SUPPLEMENT, NOT SUPPLANT. Funds made available under this subpart shall be used to supplement, and not supplant, any other Federal, State, or local funds available for physical education activities
T.V, Part D (FIE), Subpart 13, (Excellence in Economic Education)	5537	X	X	SUPPLEMENT, NOT SUPPLANT. “Funds made available to carry out this subpart shall be used to supplement, and not supplant, other Federal, State, and local funds expended for the purpose described in section
T.V, Part D (FIE), Subpart 14, (Grants to Improve the Mental Health of Children)	5541(i)	X	X	Any services provided through programs carried out under this section must supplement, and not supplant, existing mental health services, including any services required to be provided under the Individuals with Disabilities Education Act
T.V, Part D (FIE), Subpart 14, (Grants to Improve the Mental Health of Children), Section 5542 (Promotion of School Readiness Through Early Childhood Emotional and Social Development)	5542(d)(1)	X	X	SERVICES NOT OTHERWISE FUNDED - A LEA, local council, Community Based Organization (CBO), or other public or nonprofit private entity may use funds under this section only to pay for services that cannot be paid for using other Federal, State or local public resources or through private insurance.
T.V, Part D (FIE), Subpart 15, (Arts in Education)	5551(f)(2)	X		<As conditions of receiving assistance...the Secretary shall require each entity receiving such assistance...>to use such assistance only to supplement, and not to supplant, any other assistance or funds made available from non-Federal sources for the activities assisted under this subpart

ESEA (As Amended by the No Child Left Behind Act of 2001) - Excerpts Related to Supplement, Not Supplant

Applies to	Reference	May Not Supplant		Text of Provision
		Non Federal Funding Sources	Other Federal Funding Sources	
T.VI, Part A, Subpart 3 (State and Local Flexibility), Chapter A (State Flexibility Authority)	6141(c)(1)(L)	X		<A SEA shall submit an application to the Secretaryincluding> an assurance that the State educational agency will, for the duration of the grant of authority, use funds consolidated under section 6142 only to supplement the amount of funds that would, in the absence of those Federal funds, be made available from non-Federal sources for the education of students participating in programs assisted with the consolidated funds, and not to supplant those funds
T.VI, Part A, Subpart 3 (State and Local Flexibility), Chapter A (State Flexibility Authority)	6141(c)(2)(B)(iii)	X		<Each proposed performance agreement with an LEA shall> contain an assurance that the local educational agency will, for the duration of the grant of authority, use funds consolidated under section 6152 only to supplement the amount of funds that would, in the absence of those Federal funds, be made available from non-Federal sources for the education of students participating in programs assisted with the consolidated funds, and not to supplant those funds
T.VI, Part A, Subpart 3 (State and Local Flexibility), Chapter b (Local Flexibility Authority)	6151(c)(9)	X		SUPPLANTING.—The local flexibility demonstration agreement shall contain an assurance that the local educational agency will, for the duration of the grant of authority, use funds consolidated under section 6152 only to supplement the amount of funds that would, in the absence of those Federal funds, be made available from non-Federal sources for the education of students participating in programs assisted with the consolidated funds, and not to supplant those funds.
T.VI, Part B, Subpart 1 (Small, Rural School Achievement Program) and Subpart 2 (Rural and Low-Income School Program)	6232	X	X	SUPPLEMENT, NOT SUPPLANT. "Funds made available under subpart 1 or subpart 2 shall be used to supplement, and not supplant, any other Federal, State, or local education funds
T.VII, Part A (Indian Education), Subpart 1(Formula Grants to LEAs)	7114(c)(1)	X	X	<Each application submitted shall include assurances that> the LEA will use funds received under this subpart only to supplement the funds that, in the absence of the Federal funds made available under this subpart, such agency would make available for the education of Indian children, and not to supplant such funds.
T. VIII, Sec. 803 (Construction), School Facility Emergency and Modernization Grants	802(b)(5)(A)(iii)	X		SUPPLEMENT, NOT SUPPLANT.—A local educational agency shall use funds provided under an emergency grant or modernization grant awarded under this subsection only to supplement the amount of funds that would, in the absence of the Federal funds provided under the grant, be made available from non-Federal sources to carry out emergency repairs of school facilities or to carry out the modernization of school facilities, as the case may be, and not to supplant such funds.

ESEA (As Amended by the No Child Left Behind Act of 2001) - Excerpts Related to Supplement, Not Supplant

Applies to	Reference	May Not Supplant		Text of Provision
		Non Federal Funding Sources	Other Federal Funding Sources	
T. IX, Part D (Waivers)	9401(c)(4)	Notes	Notes	RESTRICTIONS-The Secretary shall not waive under this section any statutory or regulatory requirements relating to use of Federal funds to supplement, not supplant, non-Federal funds.
All Programs except T.VIII	9522	Notes	Notes	A State shall not take into consideration payments under this Act (other than under title VIII) in determining the eligibility of any local educational agency in that State for State aid, or the amount of State aid, with respect to free public education of children.
McKinney-Vento Title X (Education of Homeless Children and Youths)	McKinney-Vento Title X Section 723(2)(A)(iii)	X	X	<IN GENERAL-Services under paragraph (1)-->(iii)shall be designed to expand or improve services provided as part of a school's regular academic program, but not to replace such services provided under such program.
McKinney-Vento Title X (Education of Homeless Children and Youths)	McKinney-Vento Title X Section 723(3)	X	X	REQUIREMENT-Services provided under this section shall not replace the regular academic program and shall be designed to expand upon or improve services provided as part of the school's regular academic program.

FAQ
Supplement, Not Supplant in the ESEA
(As Amended by the No Child Left Behind Act of 2001)

Question: Many of the ESEA programs require that the federal funds supplement, not supplant other funds used for the programs. What does this mean? How do requirements to supplement, not supplant funds differ from maintenance of effort and comparability of services requirements?

Answer: There are three basic types of federal provisions in the ESEA (under the No Child Left Behind Act of 2001 (NCLB Act)) that seek to ensure that federal grant funds increase, rather than replace, existing funds for allowable activities. The three types are commonly referred to as, 1) supplement, not supplant, 2) maintenance of effort, and 3) comparability of services. Each of these is described below:

Supplement, Not Supplant

Many federal grant programs require that the federal grant funds supplement (increase), and not supplant (replace) existing funding for the activities allowed in the grant. Supplement, not supplant requirements are found throughout the NCLB Act. There is no general supplement, not supplant language that applies to the whole Act, instead each instance is applicable to a specific portion of the law. Some of the supplement, not supplant provisions in the NCLB Act refer only to supplanting state and local funds, while others also prohibit supplanting other federal funds.

Compliance with supplement, not supplant provisions is based on the theoretical answer to the question--What would the grantee or subgrantee have done in the absence of the federal grant funds? Because the question can be answered only in theory (since the federal funds are available), instances of supplanting with federal funds are often not clear. The US Department of Education's section in the OMB Circular A-133 Compliance Supplement (a guide for auditors performing single audits) lists these situations in which supplanting is **presumed** to have occurred:

- The State Education Agency (SEA) or Local Education Agency (LEA) used Federal funds to provide services that the SEA or LEA was required to make available under other Federal, State or local laws.
- The SEA or LEA used Federal funds to provide services that the SEA or LEA provided with non-Federal funds in the prior year.
- The SEA or LEA used Title I, Parts A or C funds to provide services for participating children that the SEA or LEA provided with non-Federal funds for nonparticipating children.

The Compliance Supplement goes on to explain that “these presumptions are rebuttable if the SEA or LEA can demonstrate that it would not have provided the services in question with non-Federal funds had the Federal funds not been available.”

For Title I, Parts A and C an LEA may exclude, from determinations of compliance with the supplement, not supplant requirement, State or local funds expended for language instruction educational programs; and the excess costs of providing services to children with disabilities as determined by the LEA. (NCLB Act Sec. 1120A(c)(5))

In addition, an SEA or LEA may exclude supplemental State or local funds expended in any school attendance area or school for programs that meet the intent and purposes of Title I, Part A when determining compliance with supplement, not supplant requirements under Title I, Parts A and Part C. (NCLB Act Sec. 1120A(d))

The Compliance Supplement also provides the following guidance on Title I schoolwide programs. “A school (with a schoolwide program) is not required to provide supplemental services to identified children. A school operating a schoolwide program does not have to: (1) show that Federal funds used within the school are paying for additional services that would not otherwise be provided; (2) demonstrate that Federal funds are used only for specific target populations; or (3) separately track Federal program funds once they reach the school. Such a school, **however**, is required to use funds available under Title I and under any other Federal programs that are combined to support its schoolwide program to supplement the total amount of funds that would, in the absence of the Federal funds, be made available from non-Federal sources for that school, including funds needed to provide services that are required by law for children with disabilities and children with limited English proficiency.”

Maintenance of Effort

Any LEA receiving funds under a “covered program” as defined in the NCLB Act (nearly all of the programs) are subject to maintenance of effort requirements that are found in the General Provisions portion of the law. Unlike provisions related to supplement, not supplant, compliance with maintenance of effort requirements is easily determined through a mathematical calculation. Under the NCLB Act, for any fiscal year the combined fiscal effort per student or the aggregate expenditures of the LEA from State and local funds for free public education for the preceding year should not be less than 90 percent of the combined fiscal effort or aggregate expenditures for the second preceding year, unless specifically waived by ED. In Washington State OSPI does this calculation for each district as part of its responsibilities as a “pass thru agent”. Districts that fail the annual test are informed and in limited cases may obtain a waiver.

An LEA's expenditures from State and local funds for free public education include expenditures for administration, instruction, attendance and health services, pupil transportation services, operation and maintenance of plant, fixed charges, and net expenditures to cover deficits for food services and student body activities. They do not include the following expenditures: (1) any expenditures for community services, capital outlay, debt service and supplementary expenses as a result of a Presidentially declared disaster; and (2) any expenditures made from funds provided by the Federal government.

If an LEA fails to maintain fiscal effort, the SEA must reduce the amount of the allocation of funds under an applicable program in any fiscal year in the exact proportion by which the LEA fails to maintain effort by falling below 90 percent of both the combined fiscal effort per student and aggregate expenditures (using the measure most favorable to the LEA). Reference: (NCLB Act Sec. 9521).

Other federal laws related to K-12 education in WA State (i.e. Perkins (Vocational Education), IDEA (Special Education), US Department of Agriculture Food Service programs) have their own maintenance of effort requirements that differ from those required by NCLB Act.

Comparability of Services

Like supplement, not supplant, requirements related to comparability of services are specific to particular portions of the law. An LEA may receive funds under Title I, Parts A and C only if State and local funds will be used in participating schools to provide services that, taken as a whole, are at least comparable to services that the LEA is providing in schools not receiving Title I, Parts A or Part C funds.

An LEA is considered to have met the statutory comparability requirements under Title I, Parts A and C, if it has filed with the SEA a written assurance that it has established and implemented:

- An LEA-wide salary schedule;
- A policy to ensure equivalence among schools in teachers, administrators, and other staff; and
- A policy to ensure equivalence among schools in the provision of curriculum materials and instructional supplies.

An LEA may also use other measures to determine comparability such as comparing the average number of students per instructional staff or the average staff salary per student in each school receiving Title I, Parts A or C funds with those in schools that do not receive Title I, Parts A or C funds. If all schools are served by Title I, Parts A or C, an LEA must use State and local funds to provide services that, taken as a whole, are substantially comparable in each school. Determinations may be made on either a district-wide or grade-span basis.

An LEA may exclude schools with fewer than 100 students from its comparability determinations. The comparability requirement does not apply to an LEA that has only one school for each grade span.

In addition, an SEA or LEA may exclude supplemental State or local funds expended in any school attendance area or school for programs that meet the intent and purposes of Title I, Part A, when determining compliance with comparability requirements under Title I, Parts A and C.

Each LEA must develop procedures for complying with the comparability requirements and must maintain records that are updated biennially documenting compliance with the comparability requirements. Reference: (NCLB Act Sec. 1120A)

Other federal programs related to K-12 education also have comparable services requirements (i.e. Homeless Education).

Question: How do I know whether there are supplement, not supplant provisions applicable to a particular NCLB program?

Answer: The supplement, not supplant language is found throughout the NCLB Act. A matrix with references by program is available on OSPI's ESEA website.